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IN THE

# Supreme Court of the United States.

**OCTOBER TERM, 1952**

**No. 431**

CARL J. AUSTRIAN and ROBERT G. BUTCHER, as Trustees of CENTRAL STATES ELECTRIC CORPORATION,

*Petitioners,*

—against—

HARRISON WILLIAMS, *et al.*,

*Respondents.*

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

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THE COURT PRESS, N. Y. C.

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*Petitioners,*

—against—

HARRISON WILLIAMS, *et al.*,

*Respondents.*

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## Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

*To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:*

Carl J. Austrian and Robert G. Butcher, Trustees of Central States Electric Corporation, a Virginia corporate debtor in reorganization under Chapter X of the Bankruptcy Act, and plaintiffs in the above entitled action, respectfully pray for the issuance of a writ of certiorari to review the judgment of the Court of Appeals for the Second Circuit entered herein August 15, 1952.

### BASIS OF JURISDICTION

The jurisdiction of this Court is invoked under 28 U. S. C. § 1254. The judgment of the Court of Appeals was entered August 15, 1952 (R. 747-748).

### OPINIONS BELOW

The opinion of the Court of Appeals (R. 735-746) is not yet reported. The opinion of the District Court is reported in 103 F. Supp. 64.

### QUESTIONS PRESENTED

1. Whether, in a non-diversity suit brought by trustees under Chapter X of the Bankruptcy Act to recover for

breaches of trust committed by the former dominating stockholder and corporate directors, where it appears that the defendants concealed the causes of action and dominated the Debtor, so that, by this Court's long established rule of equity, limitations are tolled, the federal equity court must nevertheless follow state cases under which such domination and concealment would not toll the period of limitations.

2. Whether, under § 11e of the Bankruptcy Act which provides that the trustee may, within a given period, sue upon claims against which "the period of limitation fixed by Federal or State law had not expired", Congress intended to refer to and incorporate state decisional law to the exclusion of federal equity decisional law.

3. Whether the provision of § 11e stated immediately above is a congressional mandate that in a non-diversity action in a federal court in equity by a federal bankruptcy trustee, the federal court shall not apply this Court's established rule of equity that the onset of even a state statute of limitation is postponed and the statute tolled where the wrongdoer has concealed the causes of action and dominated his victim.

These questions, in turn, raise and require the decision of the following corollary questions:

1. Is the decision in *Guaranty Trust Co.* v. *York*, 326 U. S. 99, limited to diversity cases or must it be applied even where the federal equity court's jurisdiction exists independently of diversity?

2. Is the rule in *Holmberg* v. *Armbrecht*, 327 U. S. 392, restricted only to cases where the basic claim in suit was created by the Congress or does it extend to cover matters rooted in federal law, such as the administration of Chapter X estates under the bankruptcy laws and the enforcement of causes of action by Chapter X trustees?

3. Does not this case arise under "the laws of the United States" within the meaning of Article III jurisdiction (Const., Art. III, § 2) so as to bring it within the *Holmberg* rule?

4. Does the rule of *Erie R. Co.* v. *Tompkins,* 304 U. S. 64, extend to this case so as to prevent federal equity courts from applying their established doctrines where appropriate mitigating circumstances exist in the interpretation of any applicable statutes of limitation?

5. Was § 11e of the Bankruptcy Act (a federal limitation statute) properly construed below in the light of its history and traditional federal equity doctrines?

6. Does not § 11e incorporate the federal equity doctrines enunciated in *Bailey* v. *Glover,*[1] *Exploration Co.* v. *United States,*[2] *Holmberg* v. *Armbrecht,* and *Michelsen* v. *Penney,*[3] tolling the running of any period of limitations where fraud, concealment, domination or other special circumstances exist?

## Statute

The relevant statute is § 11e of the Bankruptcy Act, the pertinent part of which reads as follows (11 U. S. C. A. 29):

> "A receiver or trustee may, within two years subsequent to the date of adjudication or within such further period of time as the Federal or State law may permit, institute proceedings in behalf of the estate upon any claim against which the period of limitation fixed by Federal or State law had not expired at the time of the filing of the petition in bankruptcy. * * *"

## Statement

The corporate Debtor, Central States Electric Corporation (herein called "Central States"), was an investment holding corporation incorporated in Virginia in 1912. Respondent Williams was its dominant stockholder at all the times involved in this case. In 1929, the assets of Central States were worth some $400,000,000. By Febru-

[1] 21 Wall. 342.
[2] 247 U. S. 435.
[3] 135 F. 2d 409 (2d Cir.).

ary 1942 their worth had declined to something under $2,000,000. In February 1942, Central States filed a petition for reorganization under Chapter X of the Bankruptcy Act in the Eastern District of Virginia. Trustees, predecessors to petitioners, were appointed.

These former trustees reported to the court that while wrongs had been committed by Williams against the Debtor, and causes of action existed against him, nevertheless it was their opinion that these wrongs were barred by limitations of the states where Williams could be sued. The Reorganization Court accepted this recommendation. The Court of Appeals for the Fourth Circuit reversed and directed that a new and complete investigation should be made by a "disinterested expert". The Court pointed out that "* * * suit might be brought in a federal court of equity, where, to say the least, it is extremely doubtful the statutes (of the states where the defendants might be found) would be followed. * * *" (*Committee for Holders, etc.* v. *Kent*, 4th Cir., 143 F. 2d 684, 687).

The present trustees, petitioners herein, were thereupon appointed. These trustees made the investigation directed by the Court of Appeals and recommended that suit be brought. Thereafter, on authorization of the Reorganization Court, this action was commenced in the District Court for the Southern District of New York, the district where Williams and the other defendants were found.

The complaint based itself upon "a series of transactions as wrongs committed upon Central States by Williams and (others) * * * charging that they overreached Central States in these transactions, converted, wasted, destroyed and wrongfully misappropriated and disposed of its assets, were guilty of breaches of trust and grossly mismanaged its affairs", "asking an accounting and other relief", and seeking "to enforce rights * * * cognizable only in equity and (requiring) resort to the equitable remedy of an accounting" (*Austrian* v. *Williams*, 103

F. Supp. 64, 70; *Williams* v. *Austrian*, 331 U. S. 642, 645; *Austrian* v. *Williams*, 80 F. Supp. 437, 440).

Respondents' first attack was on the jurisdiction of the District Court. Petitioners had invoked jurisdiction under the Bankruptcy Act. Respondents disputed this jurisdiction and argued that the suit was within the diversity jurisdiction only and, as such, defective. This Court sustained the non-diversity jurisdiction, emphasizing the congressional policy indicated in Chapter X to implement the duty of the trustees to investigate abuses of the old management and prosecute causes of action based thereon (*Williams* v. *Austrian*, 331 U. S. 642).

The defendants then moved to dismiss on the ground that the cause was barred by the New York law of limitations. District Judge Coxe denied the motion (80 F. Supp. 437), relying upon plaintiffs' allegations, thereafter proved, that defendant Williams had dominated the Debtor and concealed the causes of action until the filing of the petition for reorganization.

After "a long and protracted trial of an unusually complicated case" (103 F. Supp. 64, 69), the trial judge, sitting in equity, rendered judgment against Williams for breach of trust in an amount exceeding $14,000,000. The trial judge found that Williams was guilty of such domination and concealment as under federal equity principles (*Bailey* v. *Glover*, 21 Wall. 342; *Holmberg* v. *Armbrecht*, 327 U. S. 392) would toll the running of any applicable statute of limitations until the filing of the petition in bankruptcy in 1942.

The Court of Appeals (Swan and Chase, *JJ.*; Clark, *J.*, dissenting) reversed. The Court below does not in the least dispute the findings of domination or concealment or the conclusion that limitations would be tolled under the federal rule stated in *Bailey* v. *Glover* and *Holmberg* v. *Armbrecht*, *supra*. The Court below holds that the federal rule is not applicable; that by *Erie R. Co.* v. *Tompkins*, 304 U. S. 64, and *Guaranty Trust Co.* v. *York*, 326 U. S. 99, the New York case law and not this Court's

rule is to be applied to the question of tolling of limitations by concealment and domination. This, though the suit here is brought in equity by federal bankruptcy trustees upon non-diversity jurisdiction and pursuant to leave granted by § 11e, a federal statute. By the New York case law applied, the statute of limitations begins to run on the commission of the wrong regardless of the wrongdoer's concealment of the fraud or domination over his victim.

No member of the Court below defended the justice of their result. Judge Clark, dissenting, calls the New York doctrine "peculiar". The majority notes that "there are very few states * * * in accord with the New York rule" and that the general rule is that of the federal courts of equity. No authority is cited for the conclusion that the bankruptcy statute involved requires the application of the New York rule.[4]

The public interest involved in this case is extensive in respect to the impact of the decision below upon the administration of all Chapter X reorganizations and in the money amount and number of security holders here affected.

In 1951 a plan of reorganization for Central States was consummated. Under the plan, interests of junior security holders rest upon contingent assets represented primarily by recovery which may be had under the judgment against Williams—the judgment reversed by the Court below. As of February 1951, the liquidating preference of wholly unpaid junior preferred stockholders, including dividend arrears, exceeded $32,000,000. The Debtor has outstanding about 10,000,000 shares of common stock, approximately half of which is owned by the public and the remainder by Williams, who failed to file any proof of his interest for his stock in the proceeding.

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[4] Indeed the majority concede: "We have found no cases expressly deciding this point with reference to the Bankruptcy Act", although they believe that certain cases do "indicate" the result reached.

## Reasons for Granting the Writ

1. The Court below has decided an important question of federal law which has not been but should be settled by this Court. In *Guaranty Trust Co.* v. *York*, this Court held that state law governs limitations in diversity cases; in *Holmberg* v. *Armbrecht*, this Court held that federal law governs the tolling of a state statute where, in a non-diversity case, Congress had created the right sued upon. The case left for determination is the instant case, one where the part of the state in creating the right or cause of action is outweighed by the several factors demonstrating that the suit is essentially rooted in federal law. These factors include the impact of Chapter X, the appointment of federal trustees, and their right to sue in a federal court on a non-diversity basis. The Court below concedes there is no direct authority for its extension to this case of the *Erie* and *Guaranty* doctrines. The dissenting judge states that the decision is novel.

In our case the federal rights are deep in bankruptcy administration; in other cases they may involve liquidation of insured banks by the F. D. I. C., where enforcement of "state-created" claims by federal agencies as part of the congressional scheme to avoid bank failures is rooted in federal law. (*Cf. D'Oench, Duhme & Co.* v. *F. D. I. C.*, 315 U. S. 447.) Suits by federal receivers of federal banks against directors for breach of fiduciary duty (*Michelsen* v. *Penney*), by Federal Housing Authorities (*cf. United States* v. *Summerlin*, 310 U. S. 414), are but some of the many instances which come to mind. Indeed, *Osborne* v. *The Bank*, 9 Wheat. 738, was perhaps the earliest illustration of the problem; it will be recalled that the constitutional authority of Congress to grant access to federal courts by the bank was questioned because the note in suit was "state-created"; it was there decided that such a suit did "arise under the laws of the United States" so that Congress could constitutionally grant a non-diversity access to federal courts.

Does this case, which "arise(s) under the laws of the United States", fall within the scope of *Erie* as explained in *Guaranty*, or is it so rooted in federal law that, the reasons for *Erie* disappearing under the paramount weight of federal power, it falls within the scope of *Holmberg*? The majority below conceded that if *Holmberg* applied, they would have decided differently, but they distinguished *Holmberg* as a matter of "federal derivation".

The questions raised by this case should be decided by this Court since they vitally affect all bankruptcy administration under Chapter X. Just as this Court considered that it should settle the question of the jurisdiction of federal courts over actions brought by Chapter X trustees (*Williams* v. *Austrian*, 331 U. S. 642), so it should also settle the question of what rules of limitation should be applied in those suits.

2. The majority below has decided a federal question in a way which conflicts with applicable decisions of this Court.

Judge Clark, dissenting below, said (R. 745):

> "It should be stressed that this decision breaks new ground—that nothing in the exposition of the *Erie* doctrine to date compels it, while the various intimations limiting that doctrine to diversity cases point the other way."

The broad division created by *Erie* was between diversity and non-diversity cases—a division compelled by, and based on, the jurisdictional framework in Article III. Diversity cases involve state-created rights; and when *Guaranty* and *Holmberg* refer to *Erie* as laying down a rule for diversity cases where state-created rights are involved, there is a redundancy in which the phrase "state-created" rights is not the key. The broad division based on jurisdiction is the key to the area in which state law is paramount (diversity cases) and the area where federal law is supreme (non-diversity cases).

*Guaranty* itself makes this plain. There this Court repeats again and again that its decision is limited to diversity cases. In *Guaranty*, the instant petitioners, as *amici curiae*, urged that the federal equity power could not be invaded by state action. And this Court closed its opinion in *Guaranty* by stating: "But nothing that was decided, unless it be the *Kirby* case, needs to be rejected." In the *Kirby*[5] case, a federal equity court, in a diversity case, subjected the New York statute to tolling by reason of federal equity doctrines.

The fact that *Kirby*, a diversity case, was thus singled out, taken together with the repeated emphasis in *Guaranty* on the limitation of the decision to diversity cases and the special admonition that, apart from *Kirby*, no inroads were made into the federal equity power, permits only the conclusion that the federal equity rules as to tolling are to continue to apply to non-diversity cases such as the instant one.

In *Bailey* v. *Glover*, a federal bankruptcy trustee sued in a federal court on a non-diversity jurisdiction on a "state-created" right and there the historic federal doctrine was asserted that limitations would not begin to run until the period of concealment was terminated. This Court in *Guaranty* emphasized that in non-diversity cases the rule of *Bailey* v. *Glover* was unimpaired. The decision below is thus in conflict with *Erie, Guaranty, Holmberg* and with *Bailey* v. *Glover*, which require the reading of all statutes of limitation subject to the federal equitable gloss in all cases except those heard in the diversity jurisdiction.

The majority opinion below failed to consider or advert to the impact on their decision of *Bailey* v. *Glover*. Fundamentally, there is no distinction between that case

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[5] *Kirby* v. *Lake Shore & M. S. R. Co.*, 120 U. S. 130.

and our case. The following table shows the parallel between the two cases:

| | *Bailey* v. *Glover* | *The Instant Case* |
|---|---|---|
| *Nature of Right* | Action to set aside fraudulent transfer effected before bankruptcy (so-called "state-created" right). | Action to recover for breach of fiduciary conduct before bankruptcy (so-called "state-created" right). |
| *Plaintiff* | Federal bankruptcy trustee. | Federal bankruptcy trustee. |
| *Suit Brought In* | Federal Court. | Federal Court. |
| *Source of Jurisdiction of Federal Court* | Bankruptcy Act (non-diversity). | Bankruptcy Act (non-diversity). |
| *Statute of Limitations* | Federal: Bankruptcy Act 1867 § 2. | Federal: Bankruptcy Act 1898, as amended, § 11e. |

3. The majority below has construed § 11e of the Bankruptcy Act in a way which conflicts with applicable decisions of this Court.

In § 11e, Congress made explicit what has always been the federal rule (*vide*: *Campbell* v. *Haverhill*, 155 U. S. 610), in the absence of federal statutes, look for the nearest state statute. But § 11e is a federal statute of limitations: it is the direct descendant of the section in the Act of 1867 which gave rise to the *Bailey* v. *Glover* doctrine. To hold that § 11e is free of the *Bailey* v. *Glover* rule would be permissible only if there was an express direction by Congress to exclude it from this statute.

The majority conceded that if a "federal right" were involved, their decision would have gone the other way. In their minds the issue for decision was the construction of § 11e, the federal limitation statute here applicable. The statute provides that a federal trustee has a stated time to sue on claims "against which the period of limitation fixed by Federal or State law had not expired. * * *"

These words, the Court below believed, referred them to the New York statute of limitation, and the crux of the decision below is that, rejecting long established federal equitable doctrines, this statute is to be interpreted as the New York courts would interpret it, because the original breach of fiduciary conduct committed by Williams was a wrong under state law. The Court of Appeals admits it would construe § 11e as taking in New York statutes subject to the federal equity doctrine - to nullify if the "rights" were federally created. In doing so, in conflict with decisions of this Court, that this an increases federal equitable rights requiring the same time limits.

The conclusion reached below is in conflict with *Bailey* v. *Glover*, *Holmberg* v. *Armbrecht*, *Eaglton* Co. v. *United States*, and with all prior decisions of this Court as to the interpretation of federal and state limitation acts in federal courts. This Court has made it very plain

(a) that federal statutes of limitation must be construed subject to the rule in *Bailey* v. *Glover*. The source of the right in suit is unimportant; in *Bailey* v. *Glover* itself the right was state-created.

(b) that in the absence of an applicable federal statute, the federal court must look to the state statute. But the federal court is not bound by the state's interpretation of its statute; in a case involving federal equitable rights it takes the state statute subject to its own equitable doctrines.

4. The majority below further misconstrued § 11e in finding in it an express direction to eliminate federal equity doctrines. Having denied to this case the application of the words "Federal law" in § 11e, they find in the words "State law" in § 11e a congressional command to a federal court to take and apply New York decisional law and disregard the long-standing federal equity rule. The congressional command is found in the use of the word "law" which the majority below interprets to mean statute plus decisional law. But this construction is contradicted by the history of the sec-

tion. Section 11e was proposed, drafted and formulated in its present form, including the words "State law", in the years 1932 to 1935.[6] It was in this form that it was introduced into the House in July 1937[7] and passed the House on August 10, 1937.[8] It was in precisely this form when the Senate Judiciary Committee reported to the Senate on the Chandler Act including § 11e on April 20, 1938.[9] During all this time, *Swift* v. *Tyson*, 11 Pet. 1, was still unreversed and under its doctrine the word "law" meant "statute". Plainly, Congress must have understood the word "law" in § 11e, as proposed in bills submitted to it and in the bill reported to the Senate by its Judiciary Committee, to mean what this Court in *Swift* v. *Tyson* said it meant.[10] *Erie* v. *Tompkins*, which changed the meaning of "law" to include decisional law, was not decided until April 25, 1938, a few brief weeks before the Senate, based on the report of its Judiciary Committee, made before *Erie* was decided, enacted the section without change. The assumption of the majority that § 11e was enacted with the rule of *Erie* in mind is simply unfounded historically.

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[6] See "Bankruptcy Act, An Act to Establish a Uniform System of Bankruptcy Throughout the United States with Amendments Proposed by the National Bankruptcy Conference at Meetings held at Boston, St. Louis, Washington, New York, Cambridge and Chicago, beginning June 20, 1932, the final Session being held at the Chamber of Commerce of the United States, Washington, D. C., March 8-10, 1935, printed for the use of the Committee on the Judiciary, House of Representatives, 74th Congress (Tentative Draft), Committee Print, May 15, 1935." In the Preface—The Story of the Draft, the Chairman of the Conference gives the relevant history.

[7] H. R. 8046, 75th Congress, 1st Session, introduced by Representative Chandler on July 28, 1937.

[8] 81 Cong. Rec. 8649.

[9] S. Report No. 1916, 75th Congress, 3rd Session.

[10] "To ascertain its meaning we therefore consider the Congressional history of the Act, the situation with reference to which it was enacted, and the existing judicial precedents, with which Congress may be taken to have been familiar in at least a general way" (*Dist. of Columbia* v. *Murphy*, 314 U. S. 441, 449). See, also, *Morissette* v. *United States*, 342 U. S. 246, 263; *Hecht* v. *Malley*, 265 U. S. 144, 153; *United States* v. *Merriam*, 263 U. S. 179, 187.

The word "law" having been used by Congress as meaning "statute", there is no direction therein that state decisional law must be applied to the exclusion of federal equity doctrines. Section 11e, a federal statute of limitations, taking in by reference a state statute, is still to be applied subject to federal equity doctrines. Accordingly, the Court below has plainly erred in its construction of § 11e of the Act.

A proper reading of the word "law" fortifies the conclusion that the decision below is in conflict with the decisions of this Court requiring statutes of limitation to be read subject to the federal gloss. The case is, then, not in substance different from that in which no federal statute of limitations is provided, in which case federal equity courts will take state statutes of limitation subject to federal equity doctrines (*Holmberg* v. *Armbrecht, supra*).

But even if it be assumed that "State law" refers to state decisional law, the decision below is still in conflict with the decisions of this Court. The section permits suit on any claim against which the period of limitations fixed by "Federal or State law" had not expired. A plain requirement of construction would be to look to the federal law, since any claim may be prosecuted if the period of limitations fixed by either federal law or state law had not expired. If the words "State law" include decisional law, then the words "Federal law" would also include federal decisional law.[11] If we apply federal decisional law, we apply the federal equitable doctrines crystallized in *Bailey* and restated in *Holmberg*.

No reason is apparent why these doctrines should not be applied or why Congress might wish them excluded. The purpose of Congress would not be served by their exclusion. To the contrary, the decision of this Court, when it reviewed the jurisdictional basis of this case, makes it plain that Congress, by granting a federal forum, even in the absence of diversity, intended in the nationai

[11] *Warren* v. *United States*, 340 U. S. 523, 526, 527.

interest to strengthen the power of the trustee to sue to correct wrongs long concealed that the old management had committed (*Williams* v. *Austrian*, 331 U. S. 642, 657). The result below conflicts with the decisions of this Court and frustrates the objects of Congress in the enactment of Chapter X.

The Court of Appeals erred:

(a) in holding that an equity case in a federal court on a non-diversity jurisdiction is subject to the rule in *Guaranty* and not to the rule in *Holmberg*,

(b) in failing to consider and give effect to the policy of the federal statute involved, and

(c) in finding in the general words in § 11e a mandate by Congress rejecting the established rule of this Court as to the interpretation of limitation statutes.

## Prayer

For the foregoing reasons, further developed in the accompanying brief, petitioners pray that this petition for a writ of certiorari be granted, to the end that this case may be reviewed and determined by this Court; that the judgment of the Court of Appeals be reversed; and that petitioners be granted such other and further relief as may be proper.

Respectfully submitted,

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IN THE

# Supreme Court of the United States.

**OCTOBER TERM, 1952**

**No.**

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CARL J. AUSTRIAN and ROBERT G. BUTCHER, as Trustees of CENTRAL STATES ELECTRIC CORPORATION,

*Petitioners,*

—against—

HARRISON WILLIAMS, *et al.*,

*Respondents.*

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## BRIEF IN SUPPORT OF PETITION

The grounds upon which the jurisdiction of this Court is invoked, the opinions below, a summary statement of facts, and the questions presented appear in the annexed petition, and, in the interests of brevity, are not repeated. The reasons for granting the writ are also set forth above and will be elaborated briefly below.

### A.

Ever since the decision in *Erie*, it has been increasingly plain that the nature of the jurisprudence involved in the decision of questions in federal courts will depend upon the source of the federal court's jurisdiction. *Erie* made it plain that the federal courts sat as alternative state tribunals only when they were adjudicating state cases coming before them in diversity suits. But when the federal courts sit as national courts exercising a non-diversity jurisdiction, they expound a jurisprudence primarily federal. "* * * there was no purpose or effect for broadening state power over matters essentially of federal character * * *. The diversity jurisdiction had not created special problems of that sort. Accordingly the *Erie* decision, which related only to the law to be

applied in exercise of that jurisdiction, had no effect, and was intended to have none, to bring within the governance of state law matters exclusively federal, because made so by constitutional * * * command, or others so vitally affecting interests, powers and relations of the Federal Government as to require uniform national disposition rather than diversified state rulings." (*United States* v. *Standard Oil Co.*, 332 U. S. 301, 307.)

A key to the divide between *Erie* and non-*Erie* law is found in the jurisdiction of the federal court. In diversity cases state law is generally paramount; in non-diversity suits, *i. e.*, those "arising under the laws" of the United States, *Erie* has "no effect, and was intended to have none". (*U. S.* v. *Standard Oil, supra.*[12])

*First.* From the date of the decision in *Campbell* v. *Haverhill*, 155 U. S. 610 (1895), it has never been doubted that when Congress created a right without at the same time specifying any applicable period of limitations,[13] all courts—federal as well as state—will in actions at law and in the absence of special circumstances apply the state statute of limitations locally applicable to the same or similar state-created rights.[14] "* * * the silence of Congress has been interpreted to mean that it is federal policy to adopt the local law of limitation * * *" (*Holmberg* v. *Armbrecht*, 327 U. S. 392, 395), and in actions in equity the same principle obtains and "the states' statutes

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[12] *Cf.* Jackson, *J.*, concurring in *D'Oench, Duhme & Co.* v. *F. D. I. C.*, *supra*: "The Court has not extended the doctrine of *Erie R. Co.* v. *Tompkins* beyond diversity cases" (at p. 467).

[13] When "Congress explicitly puts a limit upon the time for enforcing a right which it created, there is an end of the matter. The congressional statute of limitations is definitive" (*Holmberg* v. *Armbrecht*, at p. 395). *Herget* v. *National Bank and Trust Co.*, 324 U. S. 4; *Meeker* v. *Lehigh Valley R. R. Co.*, 236 U. S. 412, 423.

[14] *Chattanooga Foundry & Pipe Works* v. *City of Atlanta*, 203 U. S. 390; *McDonald* v. *Thompson*, 184 U. S. 71; *O'Sullivan* v. *Felix*, 233 U. S. 318; *McClaine* v. *Rankin*, 197 U. S. 154; *Brady* v. *Daly*, 175 U. S. 148, 158; *L. & W. R. R. Co.* v. *Gardiner*, 273 U. S. 280, 284.

of limitations apply" (*Cope* v. *Anderson*, 331 U. S. 461, 463).[15]

*Second.* Concurrently with the development of these principles, there grew up in the federal courts a rule for the tolling of statutes of limitation where special circumstances, such as fraud, concealment, or domination, existed. Beginning with *Bailey* v. *Glover*, 21 Wall. 342 (1874), it has been the uniform rule for decision in the federal courts, in the construction of statutes of limitation, that the period therein designated will not begin to run so long as the claim is concealed or suit prevented by domination of the guilty party until the fraud is discovered[16] or the domination ends.[17]

*Third.* *Guaranty* decided that in diversity cases in federal courts state rules of limitations must be applied. But in *Holmberg*, this Court (reversing the same lower court which decided our case) held that a state statute of limitations applicable to a federal right in default of a federal statute was subject to the same federal doctrine which would toll a federal statute where fraud, concealment or other special circumstances existed.[18] A read-

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[15] In *Russell* v. *Todd*, 309 U. S. 280, 288, the Court stated the rule as follows: "In federal courts of equity the doctrine of laches was early supplemented by the rule that when the question is of lapse of time barring relief in equity, such courts, even though not regarding themselves as bound by state statutes of limitations, will nevertheless, when consonant with equitable principles, adopt and apply as their own, the local statute of limitations applicable to the equitable causes of action in the judicial district in which the case is heard."

[16] *Rosenthal* v. *Walker*, 111 U. S. 185; *Traer* v. *Clews*, 115 U. S. 528; *Exploration Co.* v. *U. S.*, 247 U. S. 435; *U. S.* v. *Diamond Coal Co.*, 255 U. S. 323; *Holmberg* v. *Armbrecht*, 327 U. S. 392; *Dabney* v. *Levy*, 191 F. 2d 201, cert. den. 342 U. S. 887.

[17] *Michelsen* v. *Penney*, 135 F. 2d 409 (2d Cir.); *Schilling* v. *Parman*, 35 F. 2d 780 (D. Ore.); *National Bank of Commerce* v. *Wade*, 84 Fed. 10 (C. C. W. D. Wash.); *Rankin* v. *Cooper*, 179 Fed. 1010 (C. C. W. D. Ark.).

[18] The subjection of *federal* statutes of limitation to the rule of *Bailey* v. *Glover* has not thus far been stated to apply only where the "cause of action" was federally created. In *Bailey* v.

[Footnote continued on following page.]

ing of *Guaranty* and *Holmberg* together in the light of their antecedent case history[19] makes it plain that it is

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*Glover*, the fraudulent transfer on which the trustee sued took place before bankruptcy; in *Dabney* v. *Levy*, the wrong on which the trustee sued likewise occurred before bankruptcy. In these two cases, as well as the others cited in Note 16, *supra*, the statute of limitations was federally enacted. On the other hand, in all the cases cited in Note 17, federal courts subjected state statutes of limitations to the *Bailey* v. *Glover* rule without regard to whether the "basic right" was enacted by Congress or by the states.

[19] After *Erie*, this Court, in *Russell* v. *Todd*, 309 U. S. 280, expressly left open "the extent to which federal courts, in the exercise of the authority conferred upon them by Congress to administer equitable remedies, are bound to follow state statutes and decisions affecting those remedies" (at p. 294). It was that question which was before the Court in *Guaranty*. In deciding that question the Court again "put to one side the considerations relevant in disposing of questions that arise when a federal court is adjudicating a claim based on a federal law" (326 U. S. at 101). Prior to *Erie*, the Court had, in *Kirby*, disregarded a state statute of limitations in a diversity suit. It was argued in *Guaranty* that the inherent power of federal equity courts to mold their own remedies as to the staleness of claims could not be invaded even in diversity cases. The Court held that such power no longer existed in diversity, but carefully (a) refrained from extending this holding to non-diversity suits and (b) closed its opinion with the statement that "nothing that was decided, unless it be the *Kirby* case, needs to be rejected" (326 U. S. at 112). What was not rejected was, clearly the power of federal equity courts in non-diversity matters to mold their own decrees and remedies as to the staleness of claims without regard to state statutes of limitations—a power thus summarized by Stone, J., in *Russell* v. *Todd* (309 U. S. 280, footnote 1, p. 288): "But federal courts of equity have not always held themselves bound to follow local statutes which in ordinary circumstances they could adopt and apply by analogy. In each case the refusal has been placed upon the ground of special equitable doctrines, making it inequitable to apply the statute. Laches may bar equitable remedy before the local statute has run. • • • On the other hand, time has been held to be no bar to an equitable suit for a trustee's accounting. • • • Federal courts of equity have

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only in diversity cases where the state law of limitations will be held paramount.

The Court below holds that state rules of limitations are paramount not only in diversity cases but even outside the diversity field excepting only where Congress has created the right. This conclusion results from disregarding this Court's limitation of the *Guaranty* rule to diversity cases and from restricting *Holmberg* without warrant to cases where Congress created the right sued on.[20] *Holmberg* emphasized that *Guaranty* applied only in diversity cases and reiterated that the doctrine of *Bailey* v. *Glover* is read into every federal statute of limitations. There is no indication in *Holmberg* that this rule of construction applied only if the original claim was federally created. In *Bailey* v. *Glover* the basic claim had its origin in state law.

But even if *Holmberg* be so restricted, the right here in suit is not merely based on the original breaches of fiduciary conduct. It is that, plus the impact of Chapter X, the appointment of federal trustees, and their right to sue in the federal court on a non-diversity basis. The entire bundle of these rights is a federal equitable right within the latitude of the *Holmberg* rule (see *United States* v. *Summerlin*, 310 U. S. 414; *Clearfield Trust Co.* v. *United States*, 318 U. S. 363).

In *Toledo Fence & Post Co.* v. *Lyons*, 290 Fed. 637, 641, Judge Denison said that such a suit by bankruptcy trustees "is one step in the collection of assets in the execution of the Bankruptcy Act. That such a case would be

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not considered themselves obligated to apply local statutes of limitations when they conflict with equitable principles, as where they apply, irrespective of the plaintiff's ignorance of his rights because of the fraud or inequitable conduct of the defendant."

[20] "• • • there remains what may be termed, for want of a better label, an area of 'federal common law' or perhaps more accurately 'law of independent federal judicial decision' outside the constitutional realm, untouched by the *Erie* decision. • • •" (*United States* v. *Standard Oil Co.*, 332 U. S. 301, 308.)

one 'arising under the laws of the United States' we think is the result of well-settled principles". And this Court approved "(this) view (as) the correct one" in *Schumacher* v. *Beeler*, 293 U. S. 367, at 371. Only recently this Court extensively re-examined the jurisdictional base of this case and a substantial majority of the Justices (Rutledge and Murphy; Vinson and Douglas; Frankfurter and Reed) concluded that the jurisdiction of the federal court is based on the Judiciary Clause of the Constitution (Art. III) because it "arises under the laws of the United States". (*National Mutual Insurance Co.* v. *Tidewater Transfer Co., Inc.*, 337 U. S. 582, 604, 626, 646.)

It is unnecessary to urge that the fact that this case arises under the laws of the United States for jurisdictional purposes makes the original wrong a right created under an Act of Congress.[21] It is sufficient to point out that that jurisdictional fact removes this case from the control of *Guaranty*, and, further, that the entire nexus of the facts here involved is, as a totality, a federal and not a state right. The essential vice of the decision below is that it selects one of the elements of the bundle of rights involved here and gives it an emphasis which subordinates national interest to state right.[22]

## B.

Basic to the decision below is the assumption that the phrase "State law" appearing in § 11e represented a congressional command to take and apply New York decisional law and thereby to overrule and disregard the federal gloss invariably applied as a matter of long-standing federal policy in the interpretation of limitation statutes. This Court has stated that it would not believe that Congress, in the enactment of limitation statutes,

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[21] And see Jackson, J., concurring in *D'Oench, Duhme & Co.* v. *F. D. I. C.*, 315 U. S. 447, at 468.

[22] This Court has emphasized that the *Erie* rule must "not impinge on federal interests" (*King* v. *Order of Travelers*, 333 U. S. 153, 157).

intended to overrule this policy and thereby give immunity to wrongdoers (*Exploration Co.* v. *United States*, 247 U. S. 435, 439). Clearly, where such a policy so long established has been thus deliberately settled, it is not lightly to be assumed that Congress intended to depart therefrom (*Robertson* v. *Labor Board*, 268 U. S. 619, 627; *Panama R. R. Co.* v. *Johnson*, 264 U. S. 375, 384). "Only compelling language in the statute itself would warrant the rejection of a construction so long and so generally accepted" (*Maynard* v. *Elliott*, 283 U. S. 273, 277). "If the rule is to be changed Congress should so declare" (*Manhattan Properties Inc.* v. *Irving Trust Co.*, 291 U. S. 320, 336). The *Bailey* v. *Glover* rule has become so integrated with the federal law of limitations that it is now part of "the warp and woof" of § 11e (see *Francis* v. *Southern Pacific Co.*, 333 U. S. 445, 450).

The majority felt that it found a Congressional direction to exclude the federal gloss in the words "State law", which they interpreted to mean statute plus decisional law. Even if that is the meaning of the words, they are far from the clear-cut Congressional command we would expect to find if Congress had intended explicitly to order federal equity courts to disregard their traditional federal policy. Nor do we find any indication of such an intent in the Committee reports or other legislative materials.[23]

Furthermore, as we have indicate above, the basic assumption of the majority below that the word "law" is intended to include decisional law is in error. The history of the section demonstrates that at the time the section was crystallized and enacted the Congress used the word "law" which then had the clear meaning of "statute".

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[23] See House Report No. 1409, 75th Congress, 1st Session (p. 20); Senate Report No. 1916, 75th Congress, 3rd Session (p. 13); 81 Cong. Rec., pp. 8646, *et seq.*; 83 Cong. Rec., pp. 8680, *et seq.*; *Weinstein*, The Bankruptcy Law of 1938, p. 41; *Op. cit.*, Note 6, *supra*, p. 32; Analysis of H. R. 12889, 74th Congress, 2nd Session, containing amendments proposed by the National Bankruptcy Conference, Committee Print, at p. 35.

The very choice of words in § 11e buttresses this conclusion. When § 11e was proposed in 1935 and subsequently enacted, the language used was "period of limitation fixed by * * * law". These words are referable only to a statute which fixes a "period of limitation". Decisional law may decide when the period fixed by statute begins to run or to what claims a period fixed by statute applies, but decisional law does not fix a "period of limitation". An act referring to a "period of limitation fixed by * * * law" would appear even more clearly to refer to a statute when we remember that the act was developed and crystallized at a time when "law" meant "statute". This being so, a holding that the words "State law" is a Congressional mandate to look to state decisions and an explicit instruction to discard firmly established federal doctrines is wholly unwarranted and unpersuasive.[24] Yet on this holding rests the entire decision below.

## C.

If § 11e requires such a construction as to conflict with the remedial purposes of Chapter X, then Congress has declared that § 11e should be excluded from application to suits under Chapter X (see Bankruptcy Act, § 102). And it should be noted that in such event the federal rule would require the application of *Bailey* v. *Glover* and *Holmberg* v. *Armbrecht* in the absence of § 11e. Section 11e does not, however, require a construction which conflicts with the remedial purposes of Chapter X. This is dem-

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[24] Other materials for giving the statute an interpretation consistent with the remedial purposes of Chapter X come readily at hand. Section 11e is a federal statute: "in the interpretation and application of Federal statutes, Federal not local law applies" (*Prudence Corp.* v. *Geist*, 316 U. S. 89, 95); besides § 11e uses the word "expired". Whether any applicable period of limitations had "expired" is a federal question (*cf. Herb* v. *Pitcairn*, 325 U. S. 77, as to "commenced"), as is also the question of the accrual of the claim (*cf. Rawlings* v. *Ray*, 312 U. S. 96). Federal rights of action, whether granted by the Bankruptcy Act or some other federal statute, "cannot be defeated by the forms of local practice". (*Cf. Brown* v. *Western R. of Alabama*, 338 U. S. 294, 296.)

onstrated by the decision of the lower court in *Dabney* v. *Levy* (L. Hand, A. N. Hand and Swan, Circuit Judges). In that case, the Chapter X trustee sued on a "state-created" claim no different from our claim. The *Dabney* claim was concededly barred under New York law at the date of suit. The question for decision there was the construction of the words "Federal or State law" in § 11e, the two year period having already expired. In *Dabney*, the lower Court held that it was not constrained by these words to look only to the state law of New York because the claim was "state-created", but that it could and would take all statutes of limitation, including § 11e, subject to the federal gloss of mitigating circumstances. In our case, the same Court (but a different bench) held that the same words in § 11e constituted a Congressional direction requiring the state law of New York to override the historic federal gloss incorporated in "Federal law". The words "Federal or State law" wherever they appear in § 11e are *in pari materia* and must have the same construction. Obviously, if the Court below was right in *Dabney*, as we believe we have demonstrated, it was wrong in our case.

It does not meet the point to assert, as the lower Court did, that these claims were barred under the New York law prior to bankruptcy, when the entire question for decision is whether the New York law applies in any event. For, if federal law applies, these claims were not barred at the inception of bankruptcy, as was the view of three of the judges to whom this question, arising in this case, was presented (Coxe and Weinfeld, District Judges, and Clark, Circuit Judge).

## Conclusion

This case is of national importance. Clark, *J.*, pointed out below that it "breaks new ground" in the federal bankruptcy field. It involves a question of serious moment in the federalism of *Erie* and the interrelation of federal and state power. It is significant because it raises for

the first time the question of the proper meaning of § 11e of the Bankruptcy Act in the light of *Guaranty* and *Holmberg*, and it is of the utmost importance if the national interests intended to be subserved by the reform of Chapter X are to be preserved, and not frustrated, and the remedies given by the Congress for rectifying corporate abuse of trust be effectuated.

Respectfully submitted,

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Dated, October 29, 1952.

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FILED
DEC 5 1952

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1952

No. 431

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CARL J. AUSTRIAN and ROBERT G. BUTCHER, as Trustees of CENTRAL STATES ELECTRIC CORPORATION,

Petitioners,

—*vs.*—

HARRISON WILLIAMS,

Respondent.

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

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## BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR CERTIORARI.

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1952

No. 431

CARL J. AUSTRIAN and ROBERT G. BUTCHER, as Trustees of CENTRAL STATES ELECTRIC CORPORATION,

Petitioners,

—*vs.*—

HARRISON WILLIAMS,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

## BRIEF OF RESPONDENT IN OPPOSITION TO PETITION FOR CERTIORARI.

### Opinions Below.

The opinion of the District Court (R. 1-109) is reported at 103 F. Supp. 64. The opinion of the Court of Appeals for the Second Circuit, and the dissenting opinion (R. 735-744), are reported at 198 F. 2d 697.

## Jurisdiction.

28 U. S. C. § 1254 is the basis of jurisdiction.

## Question Presented.

Is an ordinary civil suit on purely state-created causes of action governed by the state laws of limitation even if the plaintiff is a Chapter X trustee and asserts claims assigned to him through reorganization proceedings commenced after state limitations were a complete bar to the claims?

Section 11e of the Bankruptcy Act permits a trustee to sue on claims owned by the bankrupt "against which the period of limitation fixed by Federal or State law had not expired at the time of the filing of petition in bankruptcy." Is the "State law" which Congress commands all courts to apply —Federal and State alike—the state statute of limitation, as authoritatively interpreted by the state courts, or, may a federal court disregard the local law by imposing thereon federal notions of what the limitary period should be?

The respondent submits that the answer is that the Congress has directed that local statutes and decisional law are controlling; and that the Court of Appeals was correct in so holding; and that there is no basis for certiorari here.

## Statutes Involved.

No federal right or federal statute of limitation is being administered in this case. The claims here are derived solely from local substantive law. Local law created and completely ended the existence of the claims before any petition for bankruptcy reorganization was filed. The only federal statutes which touch the question expressly command that state law shall control here. These federal statutes appear in the appendix to this brief together with the pertinent state statutes of limitation.

## Statement.

The respondent—the majority stockholder of an investment corporation—Central States Electric Corporation—was sued by Chapter X trustees of the corporation on stock and service transactions made between the corporation and companies whose stock was wholly owned by respondent. One transaction occurred twenty-five years ago, in 1927 and three transactions occurred twenty-three years ago, in 1929.

The price or payment on three transactions was revised by the District Judge while the fourth transaction was cancelled retroactively, on grounds of legal unfairness. The Court of Appeals did not review the respondent's appeal on the merits.

No fraud or conspiracy was found by the courts below as to any transaction.

The respondent pleaded the New York statutes of limitation in bar to the claims. The District Judge specifically found that under New York law the causes of action against respondent were completely barred—they were dead "before" any reorganization proceedings in bankruptcy were commenced (R. 107).

The Bankruptcy Law, Section 11e, specifically authorizes a trustee to sue on any claim belonging to the bankrupt "against which the period of limitation, fixed by * * * State law had not expired at the time of filing of the petition in bankruptcy."

Even though it found that state law had barred these claims before the petition in bankruptcy was filed, the District Court proceeded to disregard the local law of limitations and suspended the running of the local law from the dates of accrual of the causes of action in 1927 and 1929, until the date when reorganization proceedings were commenced in 1942.

The District Judge ruled: "I hold that the running of the statute was suspended during Williams' domination"—and that this continued until the voluntary reorganization proceedings commenced (R. 105).

The findings made below (which the petitioners and the *amicus* ignore) are clear. The main activities and business of Central States were conducted in New York in an office maintained at 60 Broadway until 1931 (R. 9). It is specifically found that the transactions complained of occurred in New York; that the respondent is a resident of New York and has been present in New York continuously during and since the occurrence of each transaction in which he acted (R. 111).

Vital findings were made below as to dates. The petitioners and the *amicus* do not mention these findings.

The Court of Appeals (fol. 738) and the District Judge (R. 103) found that by local statute as well as by local decision these causes of action accrued in 1927 and 1929; that ten years thereafter was the longest possible period of limitation under New York law (fol. 738, n. 1; R. 103, 106); that suit was not brought within such ten years (R. 103); that under New York law there was no interruption or suspension of the running of time limitation on the facts of this case; that Central States, the owner of the claims, filed its petition for reorganization under Chapter X in 1942 (fol. 736); that prior to bankruptcy, Central States was totally barred by New York laws of limitation from recovery on these claims (R. 107; fol. 744); that petitioners—Chapter X trustees—suing as assignees of Central States filed this suit in 1945 (fol. 736; R. 103).

This plenary suit was brought in the federal court in New York on the jurisdiction granted by Section 2(7) of the Bankruptcy Act which entitles Chapter X trustees to "cause the assets of bankrupts to be collected" in a federal court at the option of such trustees (*Williams* v. *Austrian*, 331 U. S. 642), in addition to the available local courts.

The Court of Appeals reversed the money judgment against respondent and ordered the dismissal of the complaint be-

cause local statutes of limitation were a complete bar (fol. 747). "As we hold that this defense is sufficient, we do not find it necessary to deal with the contention of the appellant that there should also be a reversal on the merits" (fol. 738), said the Court of Appeals.

The holding of the Court of Appeals was as follows:

> "However, while the court below held that the New York statute of limitations was applicable, the statute was not applied in the same way that the New York courts would have applied it." (fol. 739)
>
> "* * * Section 11e of the Bankruptcy Act * * * expressly precludes the trustee in bankruptcy (or reorganization) from bringing suit upon 'any claim against which the period of limitations fixed by * * * State law' has expired at the time of the filing of the petition in bankruptcy. * * * We hold that this statutory scheme, as interpreted by the New York courts, is what is incorporated in Section 11e of the Bankruptcy Act and it is this composite which federal courts are directed to apply." (fol. 741)

The Court of Appeals further went on to say (fol. 741):

> 'This clear mandate to apply the state limitations statute in a case like this includes its application in the manner established by other relevant provisions of state law, N. Y. Civ. Prac. Act §11 [5], and state court interpretations of state law, *Pollack* v. *Warner Bros. Pictures, Inc., supra.*"

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"[5] Section 11 provides that the only matters which suspend the running of the limitation period are those 'specifically prescribed in the statute itself.' Some twenty-odd exceptions are specified in the Act but none of these include 'domination' or 'control' of a corporation by the defendants."

**State-created rights only are involved.**

The petition seeks vainly to find some federal quality in the rights to be administered so as to admit some basis for varying or mitigating the absolute bar of local limitations against these claims.

However, no federal right or federal statute of limitation is here to be administered.

No warrant exists here for federal decisional mitigation of local law. The Congressional command is that state limitary law shall control. Congress has expressly subordinated bankruptcy trustees to "state law." Section 11e, Bankruptcy Law. The law is no longer "state law" when the state rule is supplemented, modified, ignored or mitigated with federal doctrine.

In addition to the Bankruptcy Act, the Rules of Decision Act, 28 U. S. C. § 1652, commands adherence to state law in deciding the issue of limitations raised in this case.

The District Judge specifically found that "here, the claims are 'rested solely on state law'" (R. 98). The Court of Appeals found that "it is undisputed that these causes of action were created by state law" (fol. 738). Petitioners in the courts below accepted these holdings.

The District Judge reported in his opinion (R. 95):

> "The nature of this action has been described by the Supreme Court as one 'in equity for an accounting based on a charge that affairs of a state-created corporation had been conducted by the officers in violation of state law * * *' calling 'for a determination of no law question except those arising under state laws.'"

The quotation is from *National Mutual Ins. Co.* v. *Tide-Water Transfer Co., Inc.*, 337 U. S. 582, at pages 597, 598-9 (1949). In that case, Mr. Justice Jackson specifically referred to the case at bar as a "non-diversity suit[s] involving only state law questions" (at p. 596) and said that:

> "The only way in which any law of the United States contributed to the case was in opening the district courts to the trustee, * * *." (p. 599)
>
> "the federal law provided, not the right sought to be established, but only the authority of the trustee to establish it." (p. 599)
>
> "Neither the *Beeler* nor the *Austrian* case was one arising under the laws of the United States within the clear language of recent holdings by this Court." (p. 599)

Previously, in *Williams* v. *Austrian*, 331 U. S. 642 (1947), Mr. Justice Frankfurter had pointed in his dissenting opinion to the fact that "the basis of recovery is State law, calling for application of State law and procedure" (p. 674), and that the instant claims were "causes of action rooted in State law" (at pp. 680-1). The majority opinion does not disagree on this point.

The petitioners seemingly do not dispute that the rights or causes of action are solely state-created. Their point is that in some mystic way, the purported assignment of such lapsed state-created rights or causes of action—after the claims were outlawed—to a Chapter X trustee added federal attributes to the lapsed rights and somehow expanded the title assigned into a better title than the bankrupt assignor held and conveyed.

Stripped bare, the petitioners' erroneous theme with respect to the applicable state statutes of limitation and state decisions thereon is revealed by their argument that:

> "The source of the right in suit is unimportant; * * * in the absence of an applicable federal statute, the federal court must look to the state statute. But the federal court is not bound by the state's interpretation of its statute; * * *." (Petition, p. 11)

Plaintiffs thus base their entire position on the accident of jurisdiction.

## ARGUMENT.

### I.

### NO BASIS EXISTS FOR THE GRANT OF CERTIORARI.

The issue presented by the petition is uniquely narrow, thoroughly local, and devoid of public interest. No amount of semantics can broaden or transform the issue into one of national concern.

This suit is not part of any bankruptcy proceedings nor is it brought on bankruptcy or other federal claims. No question arises of administration of a bankrupt's estate which needs to be settled.

The only novelty involved in the case lies in the originality of the contentions of petitioners.

The case is simple and *sui generis*. The facts hearken back to 1929 and earlier years on circumstances which are unlikely ever to recur. The case is not of general importance or significance. The effect of the decision below is confined to New York and states in agreement with the same legislative policies. The state which created the claims has also legislated the lives of such claims. The state could do both. No federal law provides otherwise. Congress has expressly commanded that the limitary results of state law shall be respected and applied—and the Court of Appeals has done so here.

#### 1. No important question of federal law hitherto undecided is presented here.

Petitioners argue that there is a gap between the decisions of this Court created by the decision in *Guaranty Trust Co.* v. *York*,[1] on the one hand, and the decision in *Holmberg* v. *Armbrecht*,[2] on the other hand. Thus, petitioners say that

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[1] 326 U. S. 99 (1945).
[2] 327 U. S. 392 (1946).

*York* decided that the federal courts must apply state limitations where the basis of the Court's jurisdiction is diversity of citizenship and the rights involved are state-created, and that *Holmberg* decided that the federal courts are free to apply their own notions of limitations when the basis of the Court's jurisdiction is not diversity and the right sought to be enforced is federally created.

There is no gap, as petitioners claim. The *Holmberg* rule is based on a federally-created right and upon the premise that Congress has not spoken on the subject of limitations. The case holds that in the absence of Congressional mandate the federal court should apply the statute of the forum, subject to such federal doctrines as the Court may deem necessary to the uniform vindication of federal rights, cognizable solely in equity.

The *York* rule is based upon express Congressional enactment, viz., the Rules of Decision Act. *York* holds that a state-created right comes into federal courts subject to any infirmities placed thereon by the state.

There is no gap in the instant case between *Holmberg* and *York* because here we have an express Congressional command found in Section 11e of the Bankruptcy Act. That section, in accordance with prior decisions and previous statutory enactments, commands the application of state law where, as here, state law barred the claims sued upon prior to bankruptcy. As all the courts below have held, and as we have shown heretofore, we are here dealing with state-created rights solely.

Thus, the Court of Appeals in applying the Congressional command, did not break new ground or fill a gap. It followed clear Congressional direction to apply state law which has been consistently applied by the decisions and directed by each Bankruptcy Act since the Act of 1867.

**2. There is no conflict between the instant decision and prior decisions of this Court or of the Court of Appeals.**

Petitioners rely principally upon two decisions (*Bailey* v. *Glover*[3] and *Dabney* v. *Levy*[4]) for the asserted conflict. Neither decision is in any way in conflict with the decision of this case by the Court of Appeals.

**A. Bailey v. Glover involved federally-created rights.**

In *Bailey* v. *Glover* the action was brought not on a state-created right as petitioners assert, but to redress a violation of the Bankruptcy Act of 1867. The bill of complaint alleged a bankruptcy scheme between the bankrupt and members of his family and others to defraud the only creditor of the estate. It alleged that the bankrupt had disposed of assets and property with the intent to apply for and fraudulently to obtain a discharge in bankruptcy (par. "Sixth") that "the said discharge of Benjamin Glover in Bankruptcy was in fact fraudulently obtained" (par. "Fifteenth") and that the transferees held the assets "upon a secret trust" (par. "Eleventh"). The right asserted was thus the violation of a federal law—it was clearly federally created; it was not predicated on state law.

Moreover, it is clear from the record that in *Bailey* v. *Glover,* no state statute of limitation (Alabama) had there barred the claim sued upon at the date of the bankruptcy; none was asserted as a defense to the action. What was asserted was the two-year federal statute of limitation applicable to the period following the appointment of the assignee.

The lower court in *Bailey* v. *Glover,* clearly indicated that only federal and not state law was being considered and de-

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[3] 21 Wall. 342 (U. S. 1875).

[4] 191 F. 2d 201 (2 Cir. 1951), cert. den. 342 U. S. 887 (1951), reh. den. 342 U. S. 911 (1952).

cided. Its decree provided that "the said several causes of Demurrer be overruled with the exception of that of the statue [sic] of limitations mentioned and stated in the 2nd Section of the Bankrupt act, and relied on and assigned by each of the said defendants, and as to this cause of Demurrer assigned as aforesaid, it is ordered, adjudged and decreed, that the same be sustained; * * *." When the case reached this Court, Mr. Justice Miller made it clear that the Supreme Court was interpreting only that federal limitary period when he said (p. 349):

> "* * * in construing *this* Statute of Limitation passed by the Congress of the United States as part of the law of bankruptcy (1867), we hold that * * *," etc.

The Court did not speak of lifting or mitigating or ignoring the bar of a state statute of limitation. The statute applied by the Court in *Bailey* v. *Glover* indeed expressly forbade the result which petitioners seek to achieve here. It provided in relevant part that "nothing herein contained shall revive a right of action barred at the time such assignee is appointed." 14 Stat. 517, 518, Sec. 2 (1867).

**B. In Dabney v. Levy state statutes of limitation were not a bar before bankruptcy.**

In *Dabney* v. *Levy* it was clear, as Judge Learned Hand was at pains to point out, that the state period of limitation had not expired at the time of the bankruptcy. What the Court was dealing with in *Dabney,* as in *Bailey,* was the federal limitary period of time following the inception of bankruptcy.

**C. There is no conflict here with Erie, York or Holmberg.**

Inconsistently with their claim that the instant case presents a question hitherto undetermined by this Court, petitioners argue that the instant decision is in conflict with

*Erie*,[5] *York* and *Holmberg*. *Erie* and *York*, to the extent that they bear on the problem, support the decision below. *Holmberg* does not apply because it dealt with a right created by Congress as to which Congress was "silent" on the subject of limitations. In cases such as *Holmberg*, state limitations are utilized but are administered in accordance with federal decisions. Here, however, state-created rights only are involved and in addition Congress has spoken in clear and unequivocal terms commanding subordination to state law of limitations. No conflict with *Holmberg* arises here when the Court refuses to dilute or supplement "state" law and applies "state law" as commanded by Congress.

Petitioners also invoke on this point the overruled dictum in the *Kirby* case,[6] a diversity case. The holding of this Court was an affirmance of a decision below sustaining a demurrer to the complaint based on New York statutes of limitation; but as to the language of independence of a federal diversity court sitting in equity, *Kirby* was expressly overruled by *York*.

### 3. The decision of the Court below applies Section 11e of the Bankruptcy Act in accordance with its terms and consistently with the applicable decisions of this Court.

The construction given to Section 11e by the Court of Appeals is completely consonant with its terms and with the decisions of this Court.

Petitioners argue that the Court of Appeals bottomed its holding on state decisional law and that the term "State law" in Section 11e does not permit reference to local decisional law in applying state statutes of limitation.

The petitioners are in error both as to the basis of the holding below and as to the intrinsic and historical meaning of and the connotation applied to the term "State law."

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[5] *Erie R. Co.* v. *Tompkins*, 304 U. S. 64 (1938).

[6] *Kirby* v. *Lake Shore & M. S. R. Co.*, 120 U. S. 130 (1887).

## A.

The holding below was based on state statutes. The Court below applied Article 2 of the New York Civil Practice Act which is entitled, "LIMITATIONS OF TIME."

The New York law specifically provides that its statutory provisions "constitute the only rules of limitation applicable to a civil action" (C. P. A. § 10), and the only matters which toll the period of limitation are those "specially prescribed" in the statute itself (C. P. A. § 11).

Thus, "Under the law of this state there is a fixed limitation for every cause of action, whether legal or equitable." [7] The local statutes express the time when the period of limitation commences to run, when the time limit ends, and what are the only matters which interrupt or suspend the running of the time limit.

The matters which interrupt or suspend the running of the time limit are "specially prescribed"—these are the twenty-odd exceptions to which the Court of Appeals adverted (R. 741, ftn. 5). In New York, domination and control of a corporation or ignorance of the facts by parties in interest do not interrupt or suspend the running of time limits. Such matters are not among the items "specially prescribed" in the statutes which perform interruption or suspension of the running of time limitations. As a matter of law, no other matters are material.[8]

The New York courts have repeatedly declined to add judicially-created exceptions to the statute and have thus held that domination and control of a corporation or ignorance of the facts by parties in interest do not interrupt or

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[7] *Gilmore* v. *Ham*, 142 N. Y. 1, 6 (1894); see also, *Pollitz* v. *Wabash R. R. Co.*, 207 N. Y. 113, 130 (1912).

[8] *Mack* v. *Mendels*, 249 N. Y. 356, 359 (1928); *Erickson* v. *Macy*, 236 N. Y. 412, 415 (1923); *Gilmore* v. *Ham*, 142 N. Y. 1, 10 (1894); *Turner* v. *American Metal Co.*, 36 N. Y. S. 2d 356, 379 (N. Y. Sp. T. 1942), *aff'd on limitations, rev. o. g.*, 268 App. Div. 239 (1st Dept. 1944), *dism.* 295 N. Y. 822 (1946).

suspend the running of time limits against suit on claims like these (fol. 739).[9]

## B.

The intrinsic and historical meaning of the term "State law" is not, as claimed by the petitioners, restricted to statute law. The petitioners would restrict the words "State law" in Section 11e to state statute law. Even if so restricted, the result of this case is the same—the state statutes are a bar to this case.

Decisions of this Court make it plain that where Congress has directed the application of "State laws" as in Section 6 of the Bankruptcy Act, enacted in 1898, this Court applies state statutes in accordance with state decisional law.[10]

The same principle is followed in *King* v. *Order of United Commercial Travelers of America*, 333 U. S. 153, 157-8 (1948), where Mr. Chief Justice Vinson wrote:

> "The Rules of Decision Act commands federal courts to regard as 'rules of decision' the substantive 'laws' of the appropriate state, except only where the Constitution, treaties, or statutes of the United States provide otherwise. And the *Erie R. Co.* case decided that 'laws', in this context, include not only state statutes, but also the unwritten law of the state as pronounced by its courts.
>
> "The ideal aimed at by the Act is, of course, uniformity of decision within each state. So long as it does not impinge on federal interests, a state may shape its own law in any direction it sees fit, and it is inadmissible that cases dependent on

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[9] *Zwerdling* v. *Bent*, 291 N. Y. 654 (1943); *Laird* v. *United Shipyards, Inc.*, 163 F. 2d 12, 15-16 (2 Cir. 1947), cert. den. 332 U. S. 842 (1947); *Lyon* v. *Holton*, 172 Misc. 31, 35 (N. Y. Sp. T. 1939), aff'd 259 App. Div. 877, modified in other particulars, 286 N. Y. 270 (1941); *Turner* v. *American Metal Co.*, 36 N. Y. S. 2d 356, 381 (N. Y. Sp. T. 1942), rev'd o. g. 268 App. Div. 239 (1st Dept. 1944), dism. 295 N. Y. 822 (1946).

[10] *Page* v. *Edmunds*, 187 U. S. 596, 602 (1903); *Moody* v. *Century Sav. Bank*, 239 U. S. 374, 378, 382 (1915); *White* v. *Stump*, 266 U. S. 310, 311 (1924); *Legg* v. *St. John*, 296 U. S. 489, 496 (1936); *Myers* v. *Matley*, 318 U. S. 622, 626-7 (1943).

> that law should be decided differently according to whether they are before federal or state courts. This is particularly true where accidental factors such as diversity of citizenship and the amount in controversy enable one of the parties to choose whether the case is tried in a federal or a state court."

Similarly, in *Warren* v. *United States of America,* 340 U. S. 523, at page 526 (1951), Mr. Justice Douglas said:

> "The term law in our jurisprudence usually includes the rules of court decisions as well as legislative acts."

See also:

> *Dibble* v. *Bellingham Bay Land Co.,* 163 U. S. 63, at p. 73 (1896);
>
> *Bauserman* v. *Blunt,* 147 U. S. 647, at p. 654 (1893);
>
> *Hoskins Coal & Dock Corp.* v. *Truax Traer Coal Co.,* 191 F. 2d 912, at p. 913 (7 Cir. 1951), cert. den. 342 U. S. 947 (1952).

The petitioners next urge that Section 11e must be considered in the specific historical setting of its enactment and when so considered, the term "State law" presumably repels reference to state decisional law.

Up until *Erie* was decided (April, 1938), say petitioners, the only definition of law known to this Court and therefore to Congress was statute law. Section 11e was passed *after* the *Erie* decision (June, 1938) but, say petitioners, this revelation of the new definition of law did not penetrate the legislative mind because the Senate Committee acted before *Erie* was decided.

The petitioners' argument is wholly inadmissible since it is the knowledge of the Congress and not that of the Committee that is relevant.

Moreover, *Swift* v. *Tyson* upon which petitioners premise their argument, is to the contrary.[11] Mr. Justice Story made

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[11] *Swift* v. *Tyson,* 16 Pet. 1 at p. 18 (1842).

it plain in that case that the term "the laws of the several states," in the Rules of Decision Act, embraced "the positive statutes of the state, *and the construction thereof adopted by the local tribunals.*" (Emphasis added.)

C.

Petitioners also say that the Court of Appeals should have read Section 11e, not in accordance with what it says, but in accordance with their notions of what it should have read. Thus they argue that the phrase "State law" should not be read to mean state law in accordance with state decisional law, but should read state law, as supplemented by federal decisional law.

In *Ragan* v. *Merchants Transfer & Warehouse Co.*, 337 U. S. 530 (1949), a diversity case, this Court, per Mr. Justice Douglas, recently wrote as doctrine of universal application:

> "Since that cause of action is created by local law, the measure of it is to be found only in local law. It carries the same burden and is subject to the same defenses in the federal court as in the state court. * * * It accrues and comes to an end when local law so declares * * *. Where local law qualifies or abridges it, the federal court must follow suit * * *.
>
> "* * * local law undertook to determine the life of the cause of action. We cannot give it longer life in the federal court than it would have had in the state court without adding something to the cause of action. We may not do that consistently with *Erie R. Co.* v. *Tompkins.*" (pp. 533-4)

D.

The result which the petitioners argue for may be briefly described as follows:

On the day before Central States went into bankruptcy, if it had instituted the instant case in the court below, it is clear that that case would have been dismissed, as the instant case has been dismissed, by reason of the bar of state lim-

itations, because the only basis for federal jurisdiction would have been diversity of citizenship. *Guaranty Trust Company* v. *York*. What petitioners have said is that when the corporation instituted proceedings in Chapter X by that act it changed this result by somehow reviving a claim upon which recovery could not have been had prior to the bankruptcy.

Petitioners argue that there is something unique about a Chapter X trustee, as plaintiff, which produces this drastic result. In answer, it may be pointed out that Section 11e applies to all bankruptcy trustees. Thus, an ordinary bankruptcy trustee could have brought this suit only on the basis of diversity of citizenship or upon the consent of defendants. Bankruptcy Act, Section 23. In the case of an ordinary bankruptcy trustee there can be no doubt that the result would have been dismissal just as if the corporation itself had instituted the suit before bankruptcy.

Petitioners, apparently appreciating the length to which their position draws them, are driven to suggest that Section 11e should be read out of the provisions of the Bankruptcy Act applying to Chapter X; that on the same words, Section 11 should mean one thing for an ordinary trustee and another thing for Chapter X trustees in order to permit these plaintiffs to recover. Neither reason nor authority is given for this suggestion. The only reason that can be found is that petitioners desire to endow these claims with phoenix-like vitality—to bring to life what was clearly and completely dead.

## II.

## IN THIS CASE THE PETITIONERS SUCCEEDED TO NO GREATER RIGHTS THAN WERE OWNED BY THE BANKRUPT.

The rule of law which the petition seeks to espouse, simply put, is that liability of a defendant depends not on the strength or infirmity of a cause of action against him, but liability depends on who is the plaintiff.

**1. The title of the trustees-petitioners was subject to the limitary bar inherited therewith.**

Prior to inception of bankruptcy, the bar of limitations in a suit by Central States against the respondent was complete. The plaintiffs, Chapter X trustees of Central States, never acquired a right free of that pre-existing infirmity.

The courts below are fully agreed to the proposition that if state laws of limitation are applied to this case, in accordance with local statutes and decisions, then these claims on 1927 and 1929 transactions were fully barred by limitations of time prior to the inception of bankruptcy reorganization in 1942.

Bankruptcy results in a transfer to the trustee of title to whatever assets the debtor may lawfully possess, and the trustee becomes the holder by operation of law of claims enuring to the debtor. The trustee cannot get more.[11a]

A Chapter X trustee inherits the title of the bankrupt to choses in action belonging to the bankrupt. The assignment of the title by operation of law from the bankrupt to the Chapter X trustee is an assignment *cum onere*. An assignee's title is equated with that of his assignor.[12]

A title subject to the bar of limitations prior to assignment of that title, continues subject to the same bar of limitations after the assignment. Even the United States as an assignee is subject to this cardinal principle.[13]

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[11a] "Parties are in a bankruptcy court with their rights and duties already established, except insofar as they subsequently arise. * * *" (*Vanston Comm. v. Green*, 329 U. S. 156, 169 (1946).)

[12] Bankruptcy Act, Sec. 70, 11 U. S. C. § 110.

[13] *Guaranty Trust Co. of New York v. United States of America*, 304 U. S. 126 (1938); *The United States v. Buford*, 3 Pet. 12, at p. 30 (1830); *United States v. Nashville C. and St. L.-R. Co.*, 118 U. S. 120 (1886).

**2. A transfer of the title through bankruptcy does not revive dead claims.**

The bankruptcy reorganization of Central States had no effect on state limitations of time already run on the claims against respondent. The Bankruptcy Act has no effect on claims already dead when the petition is filed.[14]

> "And clarity of analysis justifies repetition that except where federal law, wholly apart from bankruptcy, has created obligations by the exercise of power granted to the federal government, a claim implies the existence of an obligation created by State law. If there was no valid claim before bankruptcy, there is no claim for a bankruptcy court either to recognize or to reject."
>
> *Vanston Committee* v. *Green*, 329 U. S. 156, 170 (1946).

The accident of bankruptcy or reorganization does not revive stale claims which arose prior to and without reference to the bankruptcy.[15]

The repose which limitations are designed to achieve is not less necessary or desirable nor is it to be disturbed because one of the parties to a stale transaction becomes bankrupt.[16]

The Bankruptcy Act does not create new causes of action for the trustee out of transactions made 13 to 15 years before bankruptcy[17] — petitioners' title does not include any new claims.

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[14] *Vanston Comm.* v. *Green*, 329 U. S 156, 170 (1946); *Harrigan* v. *Bergdoll*, 270 U. S. 560 (1926).

[15] *Hastings* v. *Byllesby & Co.* (*Granbery*), 265 App. Div. 653, 659 (1st Dept. 1943), aff'd 293 N. Y. 413 (1944).

[16] *Hastings* v. *Byllesby & Co.* (*Haystone*), 265 App. Div. 648, 650 (1st Dept. 1943), aff'd 293 N. Y. 404 (1944); *Guaranty Trust Company* v. *United States*, 304 U. S. 126, 136 (1938); *Schmidt* v. *Merchants Despatch Trans. Co.*, 270 N. Y. 287, 302 (1936).

[17] *Harrigan* v. *Bergdoll*, 270 U. S. 560 (1926); *Hastings* v. *Byllesby & Co.* (*Granbery*), 293 N. Y. 413, 417 (1944).

## III.

## CONGRESS HAS DIRECTED FEDERAL COURTS TO APPLY THE STATE BAR OF LIMITATIONS ON STATE-CREATED CLAIMS.

Two Congressional statutes direct that state law of limitations be applied to the facts in this case.

### 1. Section 11e of the Bankruptcy Act excludes barred claims from suits by trustees.

Section 11e of the Bankruptcy Act contains two parts. One part is a federal statute of limitations governing suits by a reorganization trustee on claims alive at the time of bankruptcy—that part of the section is not involved here. In addition, Congress specifically provided in Section 11e that claims barred by limitations before bankruptcy, are excluded from the grant to the trustee of further time for suit. The congressional intent is plainly shown in specific language. Congress stated in Section 11e that it did not intend to lift the bar of a state statute of limitations that had already run prior to the incidence of bankruptcy.

> "A receiver or trustee may * * * institute proceedings in behalf of the estate upon any claim against which the period of limitation fixed by Federal or State law had not expired at the time of the filing of the petition in bankruptcy." (*Ibid.*)

In *Herget* v. *Central Nat. Bank & Trust Co.*, 324 U. S. 4 (1945), the Supreme Court carefully pointed out that Section 11e gives the trustee the stipulated time within which to sue "provided that such law (either federal *or* state law) did not bar the action on the date when the petition was filed" (at p. 8). This is consistent with Section 70 of the Bankruptcy Act which equates the title of the trustee with that of the debtor as it existed just prior to adjudication.

This analysis necessarily flows from the language of the Bankruptcy Act and is reinforced by a history of limitary provisions in the Bankruptcy Act of 1867 and 1898.

Section 2 of the Bankruptcy Act of 1867 [14 Stat. 517, 518, Sec. 2] expressly provided:

> "But no suit at law or in equity shall in any case be maintainable by or against such assignee, or by against any person claiming an adverse interest, touching the property and rights of property aforesaid, in any court whatsoever, unless the same shall be brought within two years from the time the cause of action accrued, for or against such assignee: *Provided,* That nothing herein contained shall revive a right of action barred at the time such assignee is appointed."

Section 11(d) of the Act of 1898 [30 Stat. 549] provided:

> "Suits shall not be brought by or against a trustee of a bankrupt estate, subsequent to two years after the estate has been closed."

The Act of 1898 contained no specific language with respect to the treatment to be accorded to claims on which an applicable state statute of limitation had already run at the time of the filing of the petition or at the time of the appointment of a trustee. The courts, however, uniformly held that this section of the 1898 Act did not serve to remove the bar of the state statute of limitation when it had run against a claim.[18]

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[18] For federal authorities, see *Isaacs* v. *Neece*, 75 F. 2d 566, 569 (5th Cir. 1935); *In re Handy-Andy Stores of Louisiana*, 51 F. 2d 98, 106 (W. D. La. 1931); *In re Appalachian Publishers, Inc.*, 29 F. Supp. 1021, 1022 (E. D. Tenn. 1939); *McBride* v. *Farrington*, 60 F. Supp. 92 (D. Oregon 1945), aff'd 156 F. 2d 971 (9 Cir. 1946).

For state court authorities, see *Hansen* v. *California Bank*, 17 Cal. App. 2d 80 (3d Dist. 1936), 61 Pac. 2d 794; *Silverman* v. *Christian*, 123 N. J. Eq. 506, 198 Atl. 532 (Ch. 1938); *Sheldon* v. *Parker*, 66 Neb. 610, 92 N. W. 923 (1902); *Bovay* v. *H. M. Byllesby & Co.*, 27 Del. Ch. 33 (1943), 29 Atl. 2d 801, rev'd on o. g. in *Bovay* v. *H. M. Byllesby & Co.*, 27 Del. Ch. 381 (1944), 38 Atl. 2d 808; *Hastings* v. *Byllesby & Co.* (*Haystone*), 293 N. Y. 404 (1944); *Callaghan* v. *Bailey*, 293 N. Y. 396 (1944), at p. 400; *Devoy* v. *Superior Fire Insurance Co.*, 239 App. Div. 28 (2d Dept. 1933); *Heitfeld* v. *B.P.O.K.*, 36 Wash. 685, 220 Pac. 2d 655 (1950).

The authorities cited in the footnote 18 show that the 1898 Act was construed, in the absence of congressional provision, to permit suit by trustees only on claim "not already barred," "if prescription has not run," on "rights not barred when the petition is filed."

It was against this background that Congress enacted Section 11e of the present, the 1938 Act, which has been quoted above.[19]

The present section made perfectly clear and beyond doubt a rule of law that would have been read into the Act independently of congressional provision.

Section 11e "only undertakes to create a uniform period within which trustees may assert rights *not barred when the petition is filed.*" *In re Appalachian Publishers, Inc.*, 29 F. Supp. 1021 (E. D. Tenn. 1939).

**2. State laws are rules of decision for federal courts administering state-created rights.**

The Rules of Decision Act, 28 U. S. C. § 1652, as amended in 1948 to eliminate all doubt of its application to federal equity, provides that local laws shall be the rules of decision in civil actions in the courts of the United States, in cases where they apply.

A statute of limitation is a "rule of decision" with respect to state-created rights administered in federal courts. The Supreme Court accepted the state statutes of limitation, at an early date, as furnishing the rule of decision in federal equity as well as in law.[20]

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[19] Commentators instrumental in the preparation of the revised Bankruptcy Act specifically stated that the new Section 11e was a grant of time for the trustee to sue providing that the claims were not outlawed either by state or federal law at the date of bankruptcy. W. Randolph Montgomery, *Hearings before Judiciary Committee, Bankruptcy Sub-Committee on H. R. 1409*, 75th Cong. 1st Sess. 31 (1937); Weinstein, The Bankruptcy Law of 1938, Chandler Act, p. 41 (1938).

[20] *Harpending* v. *The Reformed Dutch Church*, 16 Pet. 455, 493-4 (U. S. 1842).

The Supreme Court, in case after case, "steadfastly and consistently" denied the notion that equity was independent from state laws as the governing rules for their decision.

The Rules of Decision Act "embraces the statutes of limitations of the several states * * *. Indeed, to no class of state legislation has the above provision been more steadfastly and consistently applied than to statutes prescribing the time within which actions shall be brought within its jurisdiction." *Campbell v. Haverhill,* 155 U. S. 610, 614 (1895).

The Rules of Decision Act even under its prior wording which referred to "rules of decision in trials at common law" was held by this Court to embrace equity cases.[21] The revision of the statute in 1948 makes abundantly clear that equity cases are embraced within the command to federal courts to apply state law to state-created rights. The statutory change was made by the use of the reference to all "civil actions."

The earlier construction was reaffirmed after *Erie* v. *Tompkins* struck down the notion of the existence of a federal common law. Referring to the Rules of Decision Act, Mr. Justice Frankfurter summarized history and stated in *Guaranty Trust Company* v. *York* [22] :

> "Although § 34 of the Judiciary Act of 1789, 1 Stat. 73, 92, 28 U. S. C. § 725, directed that the 'laws of the several states * * * shall be regarded as rules of decision in trials at common law * * *' this was deemed, consistently for over a hundred years, to be merely declaratory of what would in any event have governed the federal courts and therefore was *equally applicable to equity suits.*" (Emphasis added.)

The Reviser's Notes, appended to the Rules of Decision Act, now 28 U. S. C. § 1652, as reworded in 1948 by Congress, summarizes and confirms the foregoing as follows:

> " 'Civil actions' was substituted for 'trials at common law' to clarify the meaning of the Rules of Decision

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[21] *Mason* v. *United States,* 260 U. S. 545, 558-559 (1923).

[22] 326 U. S. 99, 103-104 (1945).

Act in the light of the Federal Rules of Civil Procedure. Such Act has been held to apply to suits in equity."

## IV.

## THE FEDERAL EQUITY COURTS HAVE IN FACT APPLIED STATE RULES ON STATE LIABILITIES.

*Guaranty Trust Co.* v. *York* held precisely and unequivocally that when a federal suit is based upon state-created rights, though it be in equity, the federal court must obey the state statutes of limitation.

The rule of limitation follows the origin of the rights to be adjudicated and does not vary from tribunal to tribunal. Logically and sensibly, there cannot be a double system of conflicting jurisprudence in administering the same state-created right. The accident of jurisdiction should not and cannot control the ultimate result. The federal court must "approximate as closely as may be State law in order to vindicate without discrimination a right derived solely from a State." [23]

Federal policy protects claims founded in federal law. In such cases no state sanctioned claim is at issue.[24]

Examples of such cases are those in which governmental functions are at issue before the court. In such cases federal uniformity is necessary.[25] The identity of the plaintiff is, of

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[23] *Holmberg* v. *Armbrecht*, 327 U. S. 392, 395 (1946).

[24] *Exploration Co.* v. *United States*, 247 U. S. 435 (1918); *Deitrick* v. *Greaney*, 309 U. S. 190 (1940); *Fisher* v. *Whiton*, 317 U. S. 217 (1942); *Wragg* v. *Federal Land Bank of New Orleans*, 317 U. S. 325 (1943); *Anderson* v. *Abbott*, 321 U. S. 349 (1944); *Steele* v. *Louisville & Nashville R. R. Co.*, 323 U. S. 192 (1944); *Tunstall* v. *Brotherhood of Locomotive Firemen & Enginemen*, 323 U. S. 210 (1944); *National Metropolitan Bank* v. *United States*, 323 U. S. 454 (1945); *Russell* v. *Todd*, 309 U. S. 280 (1940).

[25] *Exploration Co.* v. *United States*, 247 U. S. 435 (1918); *Deitrick* v. *Greaney*, 309 U. S. 190 (1940); *D'Oench, Duhme & Co.* v. *F.D.I.C.*, 315 U. S. 447 (1942); *Fisher* v. *Whiton*, 317 U. S 217 (1942); *Clearfield Trust Company* v *United States*, 318 U. S. 363 (1943); *Anderson* v. *Abbott*, 321 U. S. 349 (1944); *National Metropolitan Bank* v. *United States*, 323 U. S. 454 (1945); *United States* v. *Standard Oil Co.*, 332 U. S. 301 (1947).

courts, not determinative—the controlling factor is the cause of action.

Similarly the question of the immunity of the federal government from taxation by the states is determined by federal law.[26]

And there are cases which hold that federal courts will make their own determination of the legal effect of the facts in order to decide whether the federal Constitution has been violated.[27]

All the principles set forth in the cases cited in footnotes 24 through 27 are as unimpeachable as they are irrelevant to the case at bar.

"We put to one side the considerations relevant in disposing of questions that arise when a federal court is adjudicating a claim based on a federal law. See, for instance, *Board of Comm'rs* v. *United States*, 308 U. S. 343; *Deitrick* v. *Greaney*, 309 U. S. 190; *D'Oench, D. & Co.* v. *Federal Deposit Insurance Corp.*, 315 U. S. 447; *Clearfield Trust Co.* v. *United States*, 318 U. S. 363; *O'Brien* v. *Western Union Tel. Co.*, 113 F. 2d 539. Our problem only touches transactions for which rights and obligations are created by one of the States, and for the assertion of which, in case of diversity of the citizenship of the parties, Congress has made a federal court another available forum." *Guaranty Trust Company* v. *York*, 326 U. S. 99, 101 (1945).

Two cases which applied federal policy are cited by petitioners as significant with respect to this case. One of these, *D'Oench, Duhme & Co.* v. *F. D. I. C.*, 315 U. S. 447 (1942), involved a federal agency and was categorized by the Supreme Court as a case "adjudicating a claim based on a federal law." *Guaranty Trust Company* v. *York, supra.*

The other case cited is *United States* v. *Standard Oil Co.*, 332 U. S. 301 (1947), in which the application of state law

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[26] *United States* v. *Allegheny County*, 322 U. S. 174 (1944); *cf. Standard Oil Company of California* v. *Johnson*, 316 U. S. 481 (1942).

[27] *Cf. Ashcraft* v. *Tennessee*, 322 U. S. 143 (1944); *Smith* v. *Allwright*, 321 U. S. 649 (1944); *Lisenba* v. *California*, 314 U. S. 219 (1941).

would have interfered with the "distinctively federal" (p. 305) relation between the Government and members of its armed forces.

Self-evidently this is not a case based on a federal law or administering a federal interest.

**1. State rules govern state liabilities even if the Court's function is exclusively equitable.**

Even if the federal court is administering exclusively equitable remedies, the state rules are controlling on the federal courts in dealing with state-created rights.

In *Holmberg* v. *Armbrecht,* 327 U. S. 392 (1946), Mr. Justice Frankfurter wrote (p. 394):

> "a statute of limitation is a significant part of the legal rules which determine the outcome of a litigation. As such, it is as significant in enforcing a State-created right by an exclusively equitable remedy as it is in an action at law."

To the same effect, see:

Beale, Conflict of Laws, § 603.1 (1935);

*Ruhlin* v. *New York Life Insurance Co.,* 304 U. S. 202 (1938);

Cf. *Mason* v. *United States,* 260 U. S. 545, 557-558 (1923).

There is no conceivable distinction in this regard between diversity and non-diversity cases where state-created liabilities are being administered.

Any argument that limitations are "procedural" is held by the Supreme Court to be irrelevant to the rule that local law can and does end rights of local origin. *Guaranty Trust Company of New York* v. *United States of America,* 304 U. S. 126, 141 (1938); *Guaranty Trust Co.* v. *York,* 326 U. S. 99, 108-9 (1945).

**2. Where as here equity's remedy is concurrent with that at law, the state rules control.**

Where the equitable remedy is concurrent with an available remedy at law, the state rules of limitation will govern the suit.

> "Even though these suits are in equity, the states' statutes of limitations apply. For it is only the scope of the relief sought and the multitude of parties sued which give equity concurrent jurisdiction to enforce the legal obligation here asserted. And equity will withhold its relief in such a case where the applicable statute of limitations would bar the concurrent legal remedy."
>
> *Cope* v. *Anderson*, 331 U. S. 461, 463-4 (1947).
>
> "Even though there is no state statute applicable to similar equitable demands, when the jurisdiction of the federal court is concurrent with that of law, or the suit is brought in aid of a legal right, equity will withhold its remedy if the legal right is barred by the local statute of limitations."
>
> *Russell* v. *Todd*, 309 U. S. 280, 289 (1940).

In this case, the remedies are only equitable in form. The claims here are based on legal, not equitable primary rights, to which plaintiffs (petitioners), in their complaint, annexed equity remedies. The causes of action are in fact legal causes of action.

Consequently, the petitioners had a concurrent remedy at law for each of the claims asserted herein.[28] No unique values or articles are involved.

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[28] *Corash* v. *Texas Co.*, 264 App. Div. 292, 296 (1st Dept. 1942); *Hanover Fire Ins. Co.* v. *Morse D. D. and R. Co.*, 270 N. Y. 86, 89 (1936); *Brick* v. *Cohn-Hall-Marx Co.*, 276 N. Y 259, 264 (1937); *Dunlop's Sons, Inc.* v. *Spurr*, 285 N. Y. 333 (1941).

## V.

## THE PETITIONERS' CHOICE OF JURISDICTION DID NOT AFFECT OR ADD TO THE SUBSTANTIVE RIGHTS TO BE ADMINISTERED.

Petitioners had a choice of jurisdictional basis for their suit. They could have brought the suit in the court below on grounds of diversity of citizenship because petitioner Butcher is a Virginia resident. They chose to bring the suit on the jurisdictional basis of Section 2(7) of the Bankruptcy Act. Petitioners also could have chosen to sue in the state court. The accident of federal jurisdiction should not dictate the abandonment of local rules applicable to state-created rights.

*The means of obtaining a hearing of the claims self-evidently does not vary the source of the rights sued on.* Access to the federal court did not transform the strictly state-created rights sued on into federally-created rights. Chapter X did not create these rights; nor did any other federal law create these rights.

The source of the trustees' authority to sue is of no significance on the question whether state law or federal law is the origin of the alleged liability of respondent. The federal courts have been opened to suits to collect assets brought by Chapter X trustees. That merely unlocked the court house door to such trustees. The opening of the federal door does not change the complexion or genesis of claims antedating the bankruptcy, or the standards on which to decide the liabilities thereon created by state law.

Petitioners argue that federal equity jurisdiction has its basis in the Constitution (Article III, Section II, Clause 1) and, consequently, if state rules were to govern federal equity, albeit administering state-created rights, this would abridge constitutional equity power.

These same petitioners, as *amici curiae,* made the same argument, and it was rejected, in *Guaranty Trust Co.* v.

*York,* 326 U. S. 99 (1945). The Supreme Court necessarily rejected the same argument in two later cases.[29]

Independent (non-diversity) federal jurisdiction has not heretofore been interpreted to free a federal court from the control of state rules over state-created liabilities. Even in the absence of Congressional command to administer state law such as is contained in Section 11e of the Bankruptcy Act, federal courts in non-diversity cases have ruled that the reasons underlying the doctrine of *Erie* v. *Tompkins* as well as its rule are applicable to state-created rights.[30]

The point that the Chandler Act is a piece of national legislation and requires a national rule of limitations is peculiarly appropriate for consideration by the legislative rather than the judicial branch of the government.

Indeed, Judge Clark who dissented in the Court below, drew attention on a prior occasion[31] that much of bankruptcy depends on the interpretation of local laws, such as matters pertaining to conditional sales, chattel mortgages, conveyances in fraud of creditors and pledges. Judge Clark wrote:

> "These are matters of local property law which even under the *Tyson* doctrine were relegated to the state precedents."[32]

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[29] *Angel* v. *Bullington,* 330 U. S. 183 (1947); *Woods* v. *Interstate Realty Co.,* 337 U. S. 535 (1949).

[30] *Thompson* v. *Magnolia Petroleum Co.,* 309 U. S. 478, at p. 484 ftn. 11 (1940, Mr. Justice Black) [Bankruptcy trustee summary proceedings]; *Continental Casualty Co.* v. *Schaefer,* 173 F. 2d 5, at pp. 7-8 (9 Cir. 1949), cert. den. 337 U. S. 940 (1949) [Miller Act]; *Nat. Fruit Product Co.* v. *Dwinell Wright Co.,* 47 F. Supp. 499, at pp. 504, 509 (D. Mass. 1942, Wyzanski, D.J.), aff'd 140 F. 2d 618 (1 Cir. 1944); *cf. John F. X. Finn, as Trustee of Childs Company* v. *Empire Trust Company, et al.,* Civil 32-599, S. D. N. Y. 1950 [Chapter X trustee]; *Ladd* v. *Brickley,* 158 F. 2d 212, at p. 219 (1 Cir. 1946), cert. den. 330 U. S. 819 (1947) [Public Utility Holding Company Act trustee]; *Banister* v *Solomon,* 126 F. 2d 740 (2 Cir. 1942) [ordinary bankruptcy trustee]; *Puleo* v. *H. E. Moss & Co.,* 159 F. 2d 842 (2 Cir. 1947), cert. den. 331 U. S. 847 (1947) [Admiralty]; *Rose* v. *United States,* 73 F. Supp. 759, at pp. 763-764 (E. D. N. Y. 1947) [Admiralty].

[31] Clark, State Law in the Federal Courts, 55 Yale L. J. 267, at 281, n. 64 (1946), 5th Annual Cardozo Lecture.

[32] *Ibid.*

Judge Clark also said on the same occasion that even without explicit Congressional command to follow state law, the rule of *Erie* v. *Tompkins* and the revised view of the Rules of Decision Act should govern non-diversity as well as diversity cases. "* * * if this doctrine does not apply in non-diversity cases, we must obviously fashion one of similar character for such cases." [33]

The *Erie* case excised the notion that two sets of rules could apply to one set of state-created rights. The policy behind *Erie* and the history upon which *Erie* drew make it clear that state-created rights and liabilities, whether enforced through diversity or some other federal jurisdiction may not be decided by reference to a "general law" or "a brooding omnipresence in the sky" or the length of a chancellor's foot. "* * * it would be a mischievous practice to disregard state statutes of limitation whenever federal courts think that the result of adopting them may be inequitable." [34]

## VI.

## THE BRIEF OF THE AMICUS CURIAE IGNORES THE RECORD AND ARGUES DEHORS THE RECORD.

The *amicus curiae* has submitted a memorandum which ignores the facts of this case and ignores the facts on which *Bailey* v. *Glover* was decided. Thus, neither its argument nor its citation of authority have any relevance here.

The *amicus* bottoms its argument on a hypothetical case —not this one. It says "The Commission was not a party to the action in the courts below and took no position upon any of the issues of fact." (*Amicus* br. 4) Perhaps this explains the glaring errors and argument outside the findings and record to be found in the *amicus'* brief.

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[33] *Ibid.*

[34] Judge Augustus N. Hand, in *York* v. *Guaranty Trust Co.*, 143 F. 2d 503, 531 (2 Cir. 1944).

The short answers to the points made by the *amicus* are:

1. *Bailey* v. *Glover*, as we have seen above, administered a federally created cause of action—a fraud on the federal court—and was governed by a federal statute of limitation. In contrast, this case presents only state-created rights and a congressional direction to apply state laws of limitation. No federal statute of limitation is here involved. The principles of *Bailey* v. *Glover* are not pertinent to this case.

2. The findings below specifically rejected the contention of the petitioners that there was any improper delay calculated to aid respondent in the filing of the reorganization proceedings:

> "* * * the Court finds that the practice attacked was not designed to avoid reorganization for the purpose of protecting Williams. There was more than sufficient reason on the face of it for the corporation to try to preserve itself and for Williams, as a substantial common stockholder, to want it to survive in the hope that a rising market would rehabilitate its fortunes." (R. 91)

3. The following finding was made below concerning the disposal of records in the year 1936 and later:

> "I draw no adverse inference from the destruction or removal of Central States' records with respect to specific transactions, since it would require speculation to infer their contents." (R. 13)

4. The *amicus'* brief, in contrast to the petition, weaves into its argument the words "fraud" and "fraudulent concealment" when no such findings were made below.[35] Indeed the petitioners abandoned below the contentions of fraud and fraudulent concealment. The absence of such elements from the case and from the findings explains why both courts below relied on and ruled that the ordinary periods of limitation and not the so-called fraud discovery statutes of limitation apply; New York has both types of statutes.

The conclusion by the Court on which liability was decreed was legal unfairness in transactions of the controlling

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[35] Concealment is referred to in the context of domination, not deceit, and

stockholder with the corporation, requiring revision. Apart from the question whether the findings warranted such conclusion, the alleged legal unfairness is a far cry from the concepts gratuitously utilized by the *amicus* as the basis for its argument.

Among other liberties which the *amicus* has taken are its excursions completely outside the record, such as to inform this Court concerning matters "in 1950" *et seq.* (pp. 5-6); misdescription of our legal argument below (p. 7); reference to non-existent findings of "certain profitable contracts" (p. 7).

The one other point made by the *amicus* is that the question is of "recurring importance." Yet, fourteen years have passed under Section 11e and no one has discovered a single case suggesting the notion put forth by the petition, *viz.*, that a state-created claim barred before bankruptcy affords a basis of recovery.

## CONCLUSION.

Nothing is presented of national significance or importance. No questions are presented whose resolution will have immediate importance beyond the particular facts and parties here involved. The functions of Chapter X are not drawn into any controversy in this case. The Court below has accepted and followed Congressional command to administer state law. Such obedience presents no grounds for review by writ of certiorari.

The writ should be denied.

Respectfully submitted,

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December, 1952.

## APPENDIX.

### Federal Statutes.

The Bankruptcy Act of 1898, as amended, provides (in part):

Sec. 11e; 52 Stat. 849 (1938), 11 U. S. C. § 29e.

"*e.* A receiver or trustee may, within two years subsequent to the date of adjudication or within such further period of time as the Federal or State law may permit, institute proceedings in behalf of the estate upon any claim against which the period of limitation fixed by Federal or State law had not expired at the time of the filing of the petition in bankruptcy." * * *

The Rules of Decision Act, provides:

62 Stat. 944 (1948), 28 U. S. C. § 1652.

"§ 1652. STATE LAWS AS RULES OF DECISION.

"The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply."

### State Statutes of Limitation.

The New York Civil Practice Act, Article 2 thereof, provides in pertinent part:

"§ 10. APPLICATION OF ARTICLE. The provisions of this article apply and constitute the only rules of limitation applicable to a civil action or special proceeding, except in one of the following cases:

"1. A case where a different limitation is specially prescribed by law or a shorter limitation is prescribed by the written contract of the parties.

"2. A case where the time to commence an action has expired when this article takes effect.

"The word 'action' contained in this article is to be construed, when it is necessary so to do, as including a special proceeding or any proceeding therein or in an action."

"§ 11. MODE OF COMPUTING PERIODS OF LIMITATION. The periods of limitation prescribed by this article, except as otherwise specially prescribed therein, must be computed from the time of the accruing of the right to relief by action, special proceeding, defense or otherwise, as the case requires, to the time when the claim to that relief is actually interposed by the party as a plaintiff or a defendant in the particular action or special proceeding."

"§ 53. LIMITATION WHERE NONE SPECIALLY PRESCRIBED. An action, the limitation of which is not specifically prescribed in this article, must be commenced within ten years after the cause of action accrues."

(15515)

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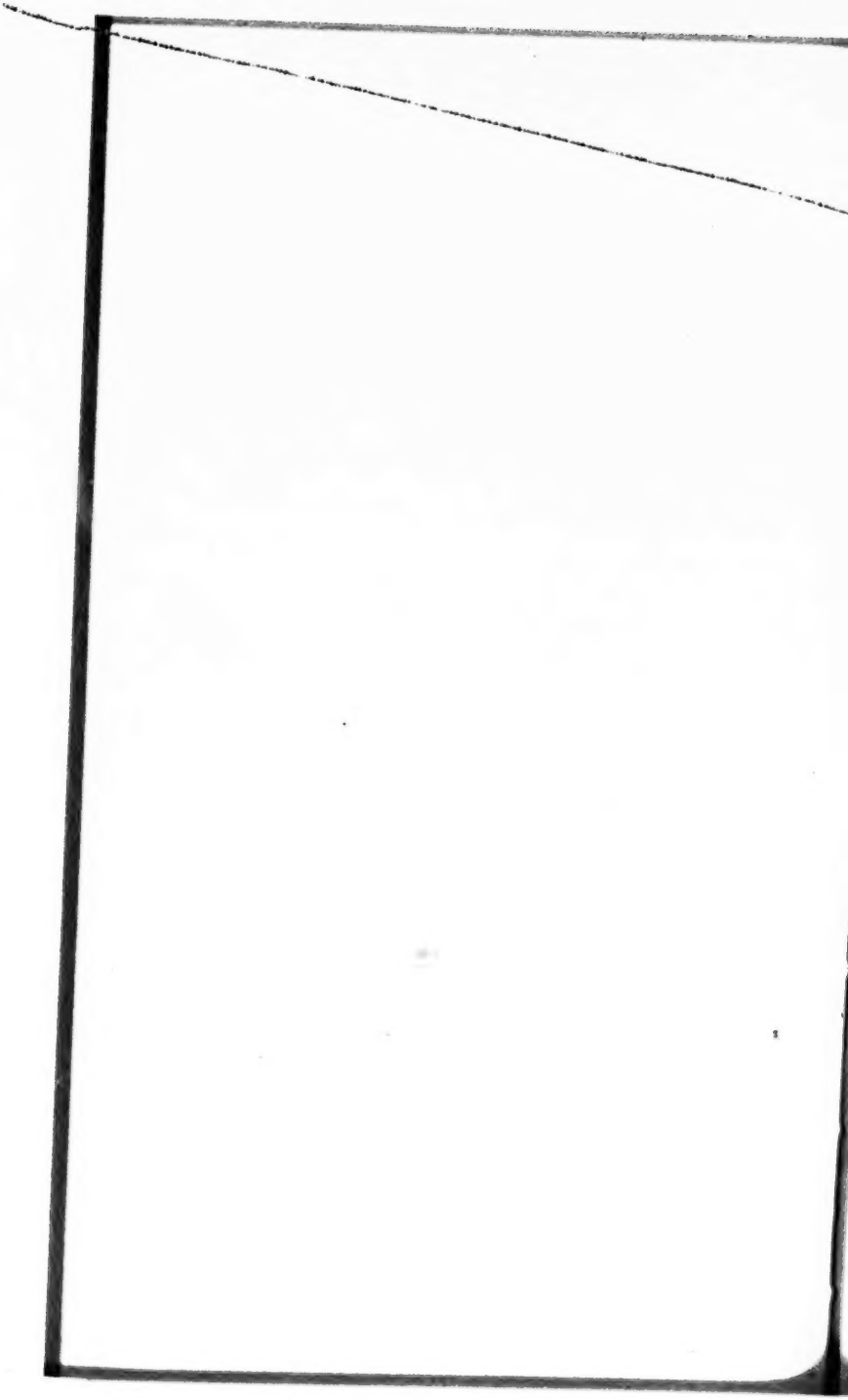

# In the Supreme Court of the United States

OCTOBER TERM, 1952

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No. 431

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CARL J. AUSTRIAN AND ROBERT G. BUTCHER, AS TRUSTEES OF CENTRAL STATES ELECTRIC CORPORATION, *Petitioners,*

v.

HARRISON WILLIAMS, ET AL.

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**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit**

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## MEMORANDUM FOR SECURITIES AND EXCHANGE COMMISSION AMICUS CURIAE IN SUPPORT OF PETITION

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The Solicitor General submits this memorandum on behalf of the Securities and Exchange Commission, *amicus curiae,* in support of the petition for a writ of certiorari.

## OPINIONS BELOW

The opinion of the Court of Appeals (R. 735-745) is reported in 198 F. 2d 697. The opinion of the District Court (R. 1-109) is reported in 103 F. Supp. 64.

## JURISDICTION

The judgment of the Court of Appeals was entered on August 15, 1952 (R. 744-745). The petition for a writ of certiorari was filed on October 30, 1952. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

## QUESTION PRESENTED

Whether, in a plenary suit for an accounting brought by Chapter X trustees against the controlling stockholder of the debtor and members of the former management for wrongs concealed by them, the federal courts in the exercise of jurisdiction under the Bankruptcy Act should follow the federal rule tolling the applicable statute of limitations for the period of concealment, or the rule of the local forum which does not toll the statute.

## STATUTE INVOLVED

The following are the pertinent provisions of the Bankruptcy Act (52 Stat. 840, 11 U.S.C. 1, *et seq.*):

> Sec. 2. * * * a. The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bank-

ruptcy and are hereby invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this Act, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to—

* * * * *

(7) Cause the estates of bankrupts to be collected, reduced to money and distributed, and determine controversies in relation thereto, * * *

* * * * *

Sec. 11. * * *

* * * * *

e. A receiver or trustee may, within two years subsequent to the date of adjudication or within such further period of time as the Federal or State law may permit, institute proceedings in behalf of the estate upon any claim against which the period of limitation fixed by Federal or State law had not expired at the time of the filing of the petition in bankruptcy. * * *

* * * * *

Sec. 216. A plan of reorganization under this chapter—

* * * * *

(13) may include provisions for the settlement or adjustment of claims belonging to the debtor or to the estate; and shall provide, as to such claims not settled or adjusted in the plan, for their retention and enforcement by the trustee or, if the debtor has been continued in possession, by an examiner appointed for that purpose * * *

## STATEMENT

The Securities and Exchange Commission is a party to the reorganization proceedings with respect to Central States Electric Corporation pursuant to Section 208 of Chapter X of the Bankruptcy Act (11 U.S.C. 608). In those proceedings, the Commission, *inter alia*, had recommended and supported the investigation which has led to the lawsuit regarding which review by this Court is now sought. *Committee, etc.* v. *Kent*, 143 F. 2d 684 (C.A. 4). The Commission was not a party to the action in the courts below and took no position upon any of the issues of fact. As *amicus curiae*, the Commission participated in the earlier phases of this litigation in this Court and in the courts below concerning the district court's jurisdiction. See *Williams* v. *Austrian*, 331 U.S. 642, affirming 159 F. 2d 67 (C.A. 2). As *amicus curiae*, the Commission also filed briefs in the courts below on the question regarding the applicable statute of limitations, and its memorandum

herein supports the trustees' petition now before this Court.

Prior to its reorganization under Chapter X, Central States, a Virginia corporation with its principal office in Richmond, Virginia, was an investment company, and registered as such under the Investment Company Act of 1940 (15 U.S.C. 80a, et seq.). A voluntary petition for reorganization under Chapter X was filed in the United States District Court for the Eastern District of Virginia on February 23, 1942, and the petition was approved on February 27, 1942 (R. 735).

In 1950, a plan of reorganization was confirmed by the Chapter X court, and was affirmed on appeal over the objections of the junior equity interests, *Central States Electric Corp.* v. *Austrian,* 183 F. 2d 879 (C.A. 4), certiorari denied, 340 U.S. 917. Under this plan, the existing and available assets of Central States were allocated to its debenture holders and its senior preferred stockholders. Excluded from participation therein were the junior preferred stock, all publicly held, and the common stock, of which 50% was held by the public and the remainder by Harrison Williams, who had filed no proof of interest for his stock in the reorganization proceeding. The participation of the publicly held junior interests was limited to the contingent assets of Central States represented primarily by the possible recovery in the suit against Harrison Williams and others, which

the court below ordered dismissed as to all defendants.

Since the lawsuit in question had not been concluded at the time the plan was confirmed, the plan provided for the retention and prosecution of this lawsuit by the trustees and for the participation by the junior equity interests in the proceeds thereof, if any should materialize, in the order of their respective priorities, subject to any prior deficiency claims of the senior preferred stockholders. This provision was incorporated in the plan pursuant to Section 216(13) of Chapter X (11 U.S.C. 616 (13)) which provides for the "retention and enforcement by the trustee" of claims "belonging to the debtor or to the estate" and "not settled or adjusted in the plan." As of February 28, 1951, the liquidating preference of the junior preferred stockholders, including dividend arrears, amounted to about $32,122,000.

On the basis of an investigation, report and recommendation by the present trustees, the Chapter X court had authorized and directed the filing of the instant suit, which was commenced on July 5, 1945, in the United States District Court for the Southern District of New York, where Harrison Williams, the principal defendant, could be found and served with process. Federal jurisdiction over this suit is not based upon diversity of citizenship, but was invoked under Section 2a(7) of the Bankruptcy Act (11 U.S.C. 11(a)(7),

*supra,* pp. 2-3), pursuant to which all district courts, as courts of bankruptcy, are vested with jurisdiction "to hear plenary suits brought by a reorganization trustee, * * *." *Williams* v. *Austrian,* 331 U.S. at 658.

The complaint, as amended, alleged waste and misappropriation of corporate assets and over-reaching by Harrison Williams, as the controlling stockholder, and others. At the conclusion of the trial, the defendants moved to dismiss the action for failure of proof and because the claims were barred by the New York statute of limitation, which, it was asserted, must be applied in this case. On the latter issue, the defendants relied in the courts below on *Erie R. Co.* v. *Tompkins,* 304 U.S. 64, and *Guaranty Trust Co.* v. *York,* 326 U.S. 99, and also invoked Section 11e of the Bankruptcy Act.

The district court sustained several of the causes of action with respect to Williams (and one other person) on the basis of findings that, as the dominant and controlling stockholder of Central States, Williams had appropriated to his own benefit certain profitable contracts in favor of Central States; that he had caused Central States to buy and sell securities at prices respectively above and below the prevailing market, all to his own benefit; and that by a retroactive arrangement a company wholly-owned by Williams was able to exact substantial

management fees, the payment of which constituted overreaching and unfair dealing with Central States (R. 25-40, 44-52, 60-63, 68-73). The court found that he must account for his wrongful acts in an amount in excess of $14,000,000, plus interest (R. 123-128).

While the transactions in question occurred in 1927 and 1929, the district court concluded that these causes of action were not barred under the New York six-year statute of limitations because (1) the doctrine of the *Erie* and *York* decisions was applicable only where jurisdiction was based upon diversity of citizenship and, therefore, did not extend to the instant case; and (2) under the established principles of federal equity, announced in *Bailey* v. *Glover*, 21 Wall. 342, 349, the running of the statute of limitation is postponed by reason of the fraudulent concealment of the wrongful acts and domination by the wrongdoer.[1] Accord-

[1] On the latter question, the district court found (R. 104):

> Williams' domination during the entire period of the transactions and up to February 1942, was so pervasive that it effectively prevented the proper institution of actions against him and the directors liable with him. The nature and extent of the domination was such as effectively to conceal by its very existence the significant facts of the transactions under attack. While there is reference to the transactions in the minute books and in the stockholders' reports, the underlying and basic facts upon which the claims rest were not, and are not, apparent from these records. The exercise of ordinary diligence by stockholders would not have exposed them. Only a thoroughgoing investigation of events which pre-

ingly, the district court held that under Section 11e the applicable New York statute of limitation —six years—began to run in 1942, when Williams' domination ceased; and since the trustees had brought the suit in 1945, the action was timely (R. 95-108).

The court below reversed, holding that Section 11e required the federal court to apply the New York statute of limitation without reference to the federal mitigating rule. As the suit was barred under New York law prior to the reorganization, the court below directed that it be dismissed (R. 735-745).

## ARGUMENT

The decision below, as Judge Clark noted in his dissent, "breaks new ground" (R. 743) and raises a question of substantial and recurring importance

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ceded, and were contemporaneous with, the transactions, most of them unrecorded, would have revealed the wrongdoing. The essential facts of the transactions remained undiscovered until sometime after his domination ceased—they were not fully revealed until after November 1944 when plaintiff Austrian was appointed as a disinterested expert. He acted promptly and vigorously, commencing this suit by authority of the Virginia District Court on July 5, 1945, some eight months after his appointment.

There is in this case also the additional element of the destruction of records, from which the inference is justified that the destroyed or removed papers contained some evidence of material facts bearing on the transactions which Williams and other directors sought to suppress.

in the administration of Chapter X, which should be settled by this Court. The effect of that decision is to deprive federal courts of their historic power to toll otherwise applicable periods of limitation in an area unaffected by the *Erie* and *York* decisions. It also permits former management to escape liability for maladministration of the debtor's affairs simply because it has successfully concealed its wrongful acts for many years prior to bankruptcy. The consequence is to nullify to that extent the broad investigatory powers of the independent trustee in the type of case for which such powers were primarily designed. The importance which Chapter X attaches to the investigatory functions of the independent trustee and to the effective prosecution of causes of action against the debtor's prior management was recognized by this Court when it considered the jurisdiction of the district court to entertain the instant suit. See *Williams* v. *Austrian,* 331 U.S. at 656-658.

For purposes of its decision the court below accepted the findings of the district court that the defendants were guilty of a breach of trust and that they had succeeded in concealing their wrongful conduct until after the institution of the Chapter X proceedings. It also took cognizance of "the federal equitable rule which suspends the running of statutes of limitations" by reason of fraud, concealment or domination, as declared by this Court in *Bailey* v. *Glover,* 21 Wall. 342, 348,

and reaffirmed recently in *Holmberg* v. *Armbrecht*, 327 U.S. 392, 396-397. Nevertheless, the court below saw in Section 11e a "clear mandate to apply the state limitations statute . . . and state court interpretations of state law" (R. 740), and held that, because the trustee's suit was brought in a federal district court sitting in New York, the district court must follow the New York statute of limitation as though it were but another local court of the state.

It is our view that Section 11e was not intended by the Congress to effect so radical a change in the historic role of federal equity. Historically, in cases of fraud, concealment or domination, federal courts of equity did not apply local statutes of limitation as such. In these circumstances, local periods of limitation were suspended until the discovery of the wrongful acts or until domination had ceased. *Bailey* v. *Glover*, 21 Wall. 342, 348; *Russell* v. *Todd*, 309 U.S. 280, 288-289; *Holmberg* v. *Armbrecht, supra*.[2] These mitigating exceptions to local law were not created by statute but have been considered by the federal courts as indigenous to their equity jurisdiction. As this Court said in the *Holmberg* case (327 U.S. at 396): "Equity eschews mechanical rules; it depends on flexibility.

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[2] The rule is, of course, much older than *Bailey* v. *Glover*. See *Michoud* v. *Girod*, 4 How. 503, 561; *Stearnes* v. *Page*, 7 How. 819, 829. See also opinion of Justice Storey in *Sherwood* v. *Sutton*, 21 Fed. Cas. 1303, 1307 (No. 12,782) (C.C.D. N.H.).

* * * If want of due diligence by the plaintiff may make it unfair to pursue the defendant, fraudulent conduct on the part of the defendant may have prevented the plaintiff from being diligent and may make it unfair to bar appeal to equity because of mere lapse of time. Equity will not lend itself to such fraud and historically has relieved from it." It is unreasonable to assume that in the context of bankruptcy administration these traditional powers of the federal courts have been abruptly curtailed by the Congress, and that under Section 11e federal bankruptcy courts, which are courts of equity and whose jurisdiction is invoked on grounds other than diversity of citizenship, must apply mechanically local rules of limitation.[3]

The fact that Section 11e does not expressly incorporate the mitigating exceptions of federal equity constitutes no "clear mandate" for their abridgement. As the district court observed, "the presumption is to the contrary" (R. 108). Section 11e is a federal statute of limitation, and so well-entrenched in federal law is the mitigating doctrine that it "is read into every federal statute of limitation." *Holmberg* v. *Armbrecht, supra,* at

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[3] Under Section 1(10) of the Act, 11 U.S.C. 1(10), "courts of bankruptcy" are defined to include "the district courts of the United States," and are not limited to the federal courts where the reorganization proceeding may be pending. See *Collett* v. *Adams*, 249 U. S. 545, 459-550; *Williams* v. *Austrian*, 331 U. S. at 658.

397. It has been applied and read into federal law, for example, where the federal statute is silent on the appropriate period of limitation, although ordinarily the silence of the Congress is "interpreted to mean that it is federal policy to adopt the local law of limitation." *Holmberg* v. *Armbrecht, supra,* at 395. The same equitable qualification was applied in *Exploration Co.* v. *United States,* 247 U.S. 435, in which the applicable statute provided in unambiguous terms that "suits to vacate and annul patents hereafter issued shall only be brought within six years after the date of the issuance of such patents" (247 U.S. at 445). Nevertheless, this Court held that the suit could be brought after the six-year period upon a showing of fraud and concealment on the part of the defendant. Despite the explicit wording of the statute, this Court said (247 U.S. at 449-450):

> When Congress passed the act in question the rule of *Bailey* v. *Glover* was the established doctrine of this court. It was presumably enacted with the ruling of that case in mind. We cannot believe that Congress intended to give immunity to those who for the period named in the statute might be able to conceal their fraudulent action from the knowledge of the agents of the Government.[4]

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[4] Of course, this equitable doctrine is not limited to cases of fraud. See *Bailey* v. *Glover, supra; Dabney* v. *Levy,* 191 F. 2d 201, 204 (C.A. 2), certiorari and rehearing denied, 342 U. S. 887, 911, discussed *infra.*

Section 11e must be read in the light of the same legislative presumption.

The same court that decided the case below has recognized that the mitigating rule of federal equity qualifies Section 11e itself in other respects, *Dabney* v. *Levy,* 191 F. 2d 201, certiorari and rehearing denied, 342 U.S. 887, 911. That case involved the provision in Section 11e which affords the trustee a minimum period of two years from the "date of adjudication" within which to bring plenary actions on behalf of the estate.[5] The court held that, where the wrongful acts had been fraudulently concealed, a federal district court in New York may entertain the suit within two years after the date of discovery, although eight years had elapsed from the date when the petition for reorganization was approved and the New York statute of limitation had expired in the same intervening years. The court said, per Judge Learned Hand (191 F. 2d at p. 205): "Indeed it would be monstrous if so bare-faced a taking of this corporation's funds as is here displayed were to escape restitution because the confederates had succeeded in keeping the transaction from detection for six years."

In the instant case, however, the court below, differently constituted, ruled that the mitigating

[5] In the context of Chapter X the phrase, "date of adjudication," means "the date of approval of a petition" for reorganization (Section 102, 11 U.S.C. 502).

rule of federal equity was inapplicable for the purpose of determining whether under the other aspect of Section 11e the action was barred in 1942, when the Chapter X proceedings were brought. The court below thought it anomalous, and contrary to a supposed policy of the Congress, to revive "causes of action which under the various applicable [state] statutes of limitations, were barred," and that the effect of applying the federal equitable rule would be "to revive, or create, causes of action, a concept without any reasonable basis" (R. 742-743). Further, since substantively the causes of action originated in state law, it felt that *Guaranty Trust Co.* v. *York*, 326 U.S. 99, though not controlling, was a more persuasive guide for determining the intent of the Congress in Section 11e (R. 740).

As heretofore noted, the mitigating exceptions of federal equity were themselves engrafted upon otherwise applicable local statutes of limitations, and federal courts have never felt that these exceptions must give way to the period of limitations which the state legislature had imposed upon the local state courts. Rather, the overriding considerations have been that in the special circumstances here in question it is "unfair to bar appeal to equity because of mere lapse of time," *Holmberg* case, 327 U.S. at 396, and that to apply the local rule would "make the law which was designed to prevent fraud the means by which it is made successful and secure," *Bailey* v. *Glover*, 21 Wall. at

349. It is unthinkable that the Congress would show greater solicitude for recreant fiduciaries who had mismanaged the bankrupt estate, and to afford them immunity against suit in derogation of the substantial interest of public investors in the accountability of these fiduciaries. On the contrary, the importance attached to the necessity of prosecuting causes of action against the former management, as noted by this Court in *Williams* v. *Austrian,* 331 U.S. at 656-658, and *Brown* v. *Gerdes,* 321 U.S. 178, 182, negatives any such Congressional intent.

The origin of the claims asserted in the instant suit is not decisive on the issue of limitations. If strictly speaking these claims are not based upon federal law, neither are they New York causes of action. As noted in the dissenting opinion below (R. 744):

> "What we are dealing with is an asset of a Virginia corporation now in the bosom of a Virginia federal court. The asset is an equitable right of accounting, based on ancient chancery principles, against a defaulting fiduciary. It is no more a New York created right than it is a Virginia or some other state created right."

The majority below agreed with the substance of these observations (R. 737-738). If New York law is not determinative of the substantive basis of

these claims, the New York statute does not extinguish these claims either.

For statutes of limitation "are by definition arbitrary", and they "go to matters of remedy, not to destruction of fundamental rights," *Chase Securities Corp.* v. *Donaldson,* 325 U.S. 304, 314, and the New York statute, which the court below deemed controlling, has thus been treated by the New York courts. See *Callaghan* v. *Bailey,* 293 N.Y. 396, 57 N.E. 2d 729 (1944). Whatever the power of New York to close its own courts to the prosecutions of these claims, clearly it did not have any power to bar their enforcement in the courts of any other state which either may have a longer period of limitation or which holds that the fraudulent concealment of the wrong tolls the running of the statutory bar. By the same token, when access to the federal courts is obtained in a jurisdictional setting in which the constitutional restraints of the *Erie* and *York* doctrines do not apply, it is for the federal courts to resolve the procedural issue of limitations in the light of their own historic conceptions of equity, unless of course the Congress has decreed otherwise. For reasons heretofore discussed, we find no such legislative intent. Indeed, the fact that Congress had freed the Chapter X trustee from the necessity of resorting to the state courts in plenary actions, as this court decided in *Williams* v. *Austrian, supra,* reinforces this conclusion.

*Guaranty Trust Co.* v. *York, supra,* is singularly inapposite. The jurisdiction there involved was based upon diversity of citizenship and this Court held that the federal district court as a consequence of the *Erie* decision must apply the local statutes of limitation because in diversity cases it is "only another court of the State" (326 U.S. at 108), and "administers the state system of law in all except details related to its own conduct of business," *Cohen* v. *Beneficial Loan Corp.,* 337 U.S. 541, 555. The instant case, however, is not based upon diversity, nor is the district court sitting as an alternate state court. The constitutional foundation of the district court's jurisdiction in this case rests upon the paramount and exclusive power of the Congress with respect to matters relating to bankruptcy, *National Mutual Ins. Co.* v. *Tidewater Transfer Co.,* 337 U.S. 582, 594-596, 611-613, 652.

Moreover, since the purpose of the present suit is to liquidate and collect an asset of the debtor in reorganization under Chapter X, the district court, so far as its jurisdiction is concerned, is acting as a court of bankruptcy (note 3, *supra*), and for purposes of bankruptcy administration is serving, as it were, as an adjunct of the primary reorganization court. We submit that the authority to invoke the federal jurisdiction under the Bankruptcy Act includes by necessary implication authority to invoke the federal court's full equity jurisdiction, irrespective of the extent to which state law may have curtailed the equity jurisdic-

tion of the state courts. That no inequity results from the application of the federal equity rule in the instant suit is beyond question. Since this is an equitable action founded in tort, these defendants have no vested interest in any particular statute of limitation. *Cf. Chase Securities Corp.* v. *Donaldson,* 325 U.S. 304, 316.

The court below apparently recognized some inconsistency between its decision and the purpose of Chapter X "for conferring upon the trustee in reorganization broad investigating powers and the duty to prosecute causes of action." Nevertheless, having been persuaded that the Congress intended to leave it within the power of a state such as New York to make the trustees' inquiry and prosecution fruitless as to defendants residing within the state, the explanation is offered that this was regarded as of relatively minor importance in view of the recognition by the Congress of "the desirability of the repose policy of the state limitations." The court below concludes that "it may well be that Congress felt the likelihood of abuse too small to make any distinction in respect to the very few states which are in accord with the New York rule" (R. 742-743).

For reasons previously discussed we find it difficult to find any valid basis for assuming that the Congress recognized the need for applying a "repose policy" in defiance of the historic principles of federal equity. We find it equally hard

to believe that, in legislating for the protection of investors throughout the nation who might be affected by the administration of Chapter X, the Congress would allow even the single State of New York, which embraces such a substantial segment of the financial community, to provide "cities of refuge" (Numbers 35: 11-15) for resident members of the debtors' management who had successfully concealed their tortious conduct. It is far more likely that the Congress was either unaware of the peculiar New York rule, or assumed that the New York rule would not interfere with the fulfillment of the policies of Chapter X in view of the established principles of federal equity which are incorporated into every federal statute of limitation.

## CONCLUSION

For the foregoing reasons the petition for a writ of certiorari should be granted.

Respectfully submitted,

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